

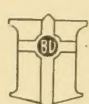





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## COLLEGE OF BUSINESS ADMINISTRATION

THE HOLDING COMPANY

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B. A. Boston University 1923)

MASTER OF BUSINESS ADMINISTRATION

1937



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## FOREWORD

One of the problems of business facing the Nation at the present time is that of the holding company in the public utility field. It is one phase of the larger and constant problem of the control of "big business".

It has been claimed that the holding company movement in the utility field has not been treated from the economic viewpoint. Our economic and governmental concepts are now in a state of flux. Questions which are fundamentally economic have become political, not only because of their nature, but by designing politicians. The problem has become complicated because of the vast amount of literature in the newspapers and magazines, consisting of propaganda by both governmental and anti-governmental agencies.

To alleviate the confusion of the mind resulting from the above conditions and to clarify the issues on this problem so intimately associated with the public ownership and power issues, it is necessary to make an impartial investigation to determine what the problem is and how it is being met.

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The holding company movement in the public utility field attracted my attention while I was studying holding companies in preparation for the examination set by the



Massachusetts Board of Registration of Certified Public Accountants. When Professor O'Neil of the faculty suggested the subject, I was glad of the opportunity to further my study of this aspect of the holding company problem, a subject which I have always desired to investigate further and to bring my observations up-to-date.

Not only do I have this personal interest in the subject matter, but I feel my duty as a good citizen necessitates a deep investigation of an issue before the American people at the present time.

Because of the size and importance of the holding company, it is necessary to limit the subject matter in this study so as to be able to present it thoroughly in the time and space allotted. It is in the public utility field that the holding company has made its most rapid and complete development and it is in this field that it has been subjected to most criticism.

A study of the holding company in the electric light field was made by Douglas Hamilton Bellemore in 1932. Since that date, there have been many developments both in the electric utility holding company field and in utility holding company legislation. The above study has shown the effect of the introduction of the holding company on the electricity field. This thesis will study the holding com-







pany and the effect a monopolistic or semi-monopolistic field will have on it.

What is the holding company problem? It is my intention to show what it is by first defining the holding company and comparing it with other types of business combinations. By studying its history too, we can get an insight as to its function.

A determination of the problem also necessitates a differentiation between the terms, "public utility" and "the public utility holding company."

Finally, one of the most important and newest factors to be discussed is that of the relationship of the government.

My information has been obtained from a wide reading of textbooks, state and federal publications, periodicals and newspapers, court decisions and opinions, and other publications and reports--a list of which will be found in the bibliography at the end of this thesis.



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PART I  
THE HOLDING COMPANY

Companies engaged in industry and commerce have often found it desirable to combine with other companies. There are various forms of business organizations that can be used. One of these is the holding company.

I Definition

What is a holding company? There are many definitions. One of these, legally correct and widely quoted, by Bouvier is, "A corporation organized to hold the stock of another or other corporations." (1) Under this definition, any corporation that has the power to hold stock certificates representing shares of ownership in another corporation, becomes, upon exercise of this power, a holding company.

There are three difficulties with this definition. In the first place, there is the possibility of misinterpretation. It has been charged that certain corporations chartered by authority of Congress are holding companies because the government grants them the power, among others, of holding stock in other corporations. A strict interpretation of this definition, while not perhaps the one most common, would uphold the person or persons making this claim.

The second objection lies with the word "corporation." This definition would limit the holding company to the

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(1) BOUVIER, LAW DICTIONARY, p.1445





corporation, whereas, it has been found that unincorporated companies can be and also are holding companies. We, therefore, can refer to a definition by Professor Haney: "A holding company is a business organization which is created for the purpose of combining other corporations by owning a controlling amount of stock."(1)

In the third place, the granting of liberal powers to corporations in the matter of ownership of stock in other corporations, and the development of corporations which own stock in other companies for purposes other than control and management, has made it necessary to limit the definition of the true holding company to those corporations controlling and managing other corporations. We can refer to a definition by Professors Bonbright and Means: "A holding company is any company, incorporated or unincorporated, which is in a position to control, or materially influence, the management of one or more other companies by virtue, in part at least, of its ownership of securities in the other company or companies."(2)

Jones and Bigham define it as: "The companies that hold all or a majority of the stock of various operating companies, and by virtue of the control thus exercised, manage the affairs of the subsidiary companies."(3)

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(1) L. H. HANEY, BUSINESS ORGANIZATION AND COMBINATION, p.248

(2) BONBRIGHT AND MEANS, THE HOLDING COMPANY, p.10

(3) JONES AND BIGHAM, PRINCIPLES OF PUBLIC UTILITIES, p.589





These definitions point out that the term "holding company" has now been widely adopted to designate that form of business organization by which a number of business units are brought together under a single centralized authority because of ownership of stock in the units and by which the policies of the entire system are dictated.

It necessarily involves the creation or prior existence of a company which has the power to hold the stocks of other companies. In corporations, this power, like any other corporate power, must be definitely granted by the state of incorporation.

The controlled corporations are nominally and legally independent and operate under their own names. They can be effectively managed by officers of the holding companies of whom the directors vote the stocks held by the holding company, or a controlling part thereof, and so elect the directors of the controlled companies.

The securities of the corporations to be controlled are obtained either by a direct exchange for those of the holding company or by purchase for cash which has been previously obtained by the sale of securities of the holding company.

## II Types

Pure holding companies may be distinguished from operating or mixed holding companies.(1) A pure holding

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(1) HANEY, op. cit., p.267





company is a corporation organized for the purpose of acquiring primarily the voting stocks and other voting securities of other corporations and does not engage directly in the management of the constituent plants. Generally, but not necessarily, it holds not less than a majority of the voting securities of any company.

The pure holding company is not an operating company. Its management is concerned chiefly with establishing policies, leaving the details of the execution of those policies, and the actual operations to the experts in each company.

Operating holding companies or the mixed holding companies are companies which are engaged in one or more lines of business activity and also own securities of other corporations. Very commonly, such companies are the head or nucleus of a subgroup of companies. Cases of this kind range from those in which the holding of other companies' securities is incidental, measured by the relative investment in such securities and in operating facilities, to those in which operations are subordinate in importance to the ownership of securities. Usually, operating holding companies are not implied by the customary use of the term, "holding company." (1)

Holding companies can be classified also according to the relative time of formation. (2) If a holding company is formed

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(1) DEWEY, FINANCIAL POLICY OF CORPORATIONS, p.857

(2) BONNEVILLE, ELEMENTS OF BUSINESS FINANCE, p.277





first and later organizes its subsidiaries, it is known as a "parent" company. The American Telephone and Telephone Company, with its many state and regional subsidiaries throughout the United States, is an excellent example of this type.

Where, as in the majority of cases, holding companies have been formed to consolidate the control of existing corporations, they are classified as "consolidated," or off-spring holding companies. The Consolidated Gas Company of New York is an example of this type.

Again, holding companies may be classified according to their relative position of control. "Primary holding company," "top holding company," and "system holding company" are terms used to designate that holding company which constitutes the single head of a system of subsidiary companies.(1) Sometimes the term "primary control company" etc. is used in the same significance.

"Intermediary holding company," "intermediate holding company," "subholding company," "subsidiary holding company," and "subordinate holding company" are terms used to designate those holding companies which in turn are controlled by other holding companies. They are agencies through which another corporation accomplishes its purpose.

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(1) FIELD, UNIVERSITY OF COLORADO STUDIES, p.229





A useful and legitimate variety of the holding company is the parent company and subcompanies. In the case of an invention to be exploited, the parent company may hold title to the patents, licensing the subordinate companies in each state to handle the invention locally.(1)

There are three types of holding companies: management, financial, and investment. The holding company which combines independent companies under a centralized management or control is an example of the first type. These "control" companies direct the policies of the other companies through ownership of a majority or more of the voting stock of the latter.

The financial holding company is a holding company whose primary function is to make profits by financing the operations of other companies through promotions, underwriting, and reorganization. Incidentally, it may exercise more or less control over the companies which it finances, but this is not its main purpose and the control is temporary during its financing period. The income from dividends or interest on investments is not a chief consideration.

The investment holding company has as its chief purpose the holding of securities in other companies for the

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(1) ACCOUNTANTS' HANDBOOK, p.210





sake of income and long-pull appreciation. Such an organization would ordinarily avoid control and would seek diversity of holdings. In typical cases, the investing company is formed to handle the funds of an individual, a family or a small group.

"Investment trust" is a loose expression which is used to designate several types of securities owning organization and may be investment holding companies.(1)

### III Objectives

The objective of the holding company (from the point of view of its promoters) are both managerial and financial.(2)

#### A. Managerial

The managerial objectives consist of so arranging the capital structures of the subsidiaries and the holding company so as to give control with the least possible investment and to take advantage of large scale operations through the mechanism of pooled services of management and engineering facilities.

The most distinctive characteristic of the holding company is the pyramid corporate structure. A relatively small investment in the common stock in the higher levels of a pyramided structure may represent absolute control of underlying operating companies with assets of millions of dollars.

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(1) FIELD, loc. cit.

(2) THE LINCOLN LIBRARY OF ESSENTIAL INFORMATION, p.1265





It is obtained by holding a majority of the voting stock of a corporation. This corporation in turn holds the majority voting stock in another corporation. This process is repeated a number of times and by the introduction of two or three intermediate companies, and the issuing of bonds and nonvoting preferred stock or stock with unequal voting rights, complete control of a large operating company can be secured and maintained by an ownership interest equal to a fraction on one per cent of the property controlled, according to Berle and Means.(1)

Professor William Z. Ripley describes its effect thus:

"A ten per cent ownership, most of which does not cost the owners a penny, carries control of the remaining nine-tenths of the participation."(2)

#### B. Financial

The holding company is a device for centralizing finances. The financial objectives of the holding company are united financing, the advancing of money to subsidiaries, and capital inflation.

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(1) BERLE AND MEANS, MODERN CORPORATION AND PRIVATE PROPERTY, pp.72 and 73

(2) RIPLEY, MAIN STREET AND WALL STREET, p.119





These objectives may be attained by causing the holding company not merely to purchase a controlling interest in the outstanding stock of its subsidiaries, but also to sell to the public its own securities.

The primary reason for this financial use of the holding company is to be found in the superiority of the larger organization. Small enterprises find it difficult to raise capital, partly because small security issues are unknown and are not desired by investment banks, partly because a limited and local enterprise does not enjoy the diversity of risk which characterizes a larger system.

United financing can be utilized in three directions: the indorsement of securities of the subsidiaries, the marketing of the securities of both the holding and the subsidiaries, and the advancing of money by the holding company.

Capital inflation can be obtained by recapitalizing the financial structure of one or more enterprises through a substitution of the securities of the holding company for the securities of the subsidiary companies. This may result in the placing of a higher value on the subsidiary and is known to the man on the street as, "watering the stock."





### A. Prior to 1888

Prior to 1888, a few companies had the privilege of owning stock by special legislative enactment, while no state empowered a company to hold stocks of another under its general incorporation laws. Some states, including Pennsylvania, definitely forbade intercorporate holdings.

The holding company was introduced in the railroad field. The Baltimore and Ohio Railroad Company, founded in 1832, appears to be the earliest holding company in the United States. Other early holding companies are the Pennsylvania Railroad Company, 1853; Chicago & Northwestern Railway Company, 1864; and the Western Union Telegraph Company, 1851.

Perhaps the first real holding company of large size was the Pennsylvania Company. It was organized in 1870 under special enactment of the state legislature in the interest of the Pennsylvania Railroad to permit the latter to centralize control of certain lines.

Much of the early history of the holding company was written in the oil industry. The South Improvement Company created by a special act of the Legislative of Pennsylvania in 1871 and said to have been a factor in the practice of railroad rebating by the Rockefeller interests, was one of the earliest companies formed. Its charter was revoked in 1872.





### B. After 1888

In 1888, 1889, and 1893, the State of New Jersey added to its general stock incorporation law provisions making it possible for a corporation formed under it to include in their charter the specific power to hold stock in other corporations; something theretofore allowed only by special grant, as we have noted. According to J. L. Jackson, it is not easy to allay the suspicion that those who fostered the creation of this right anticipated the passage of the Sherman Anti-Trust Act in 1890, which made illegal "every contract or combination...in restraint of trade or commerce." (1) In 1890 and 1892, the so-called trust form of organization was declared unlawful in the so-called Sugar Trust and Standard Oil Company cases. This led to the belief that "big business" would utilize the holding company idea.

It is well to note that at this period other states were moving to legalize the holding company device at the very time that the Federal Government was endeavoring to stamp out the evil usages of the pooling and trust devices.

Between 1893 and 1897, few corporations took advantage of the holding company plan because of the unsatisfactory state of business during that period.

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(1) FEDERAL TRADE COMMISSION, Senate Document #92, #73A, p.195





Between 1898 and 1904, a number of industrial securities holding companies were organized. This was a period after the trusts were ruled out and during an epoch of complete or nearly complete consolidation in industrial and railway businesses.

Holding companies were attacked under the provisions of the Sherman Law prohibiting combinations in restraint of trade and monopolies. In one case, the Northern Securities Company, a holding company formed for the purpose of holding stock in the Great Northern and Northern Pacific Railway Companies, was enjoined in 1904, from voting any of the stock held and the constituent companies were enjoined from paying dividends to the Northern Securities Company. (Northern Securities Co. vs. U. S. 193 U. S. 197)

It became evident that holding companies, if in restraint of trade, would be declared illegal. This tended to somewhat check the holding company movement. In 1911, the Supreme Court in the "Standard Oil" and "Tobacco" cases decided that the language of the Sherman Act meant and had always meant that only contracts "unreasonably" restraining trade were illegal and ordered the Standard Oil Company and the American Tobacco Company dissolved. Previously, in a series of cases heard during the years 1894 to 1896, the Supreme Court refused to construe the





Sherman Act as prohibiting merely those contracts "unreasonably" restraining trade and steadfastly and repeatedly refused to apply this so-called "rule of reason." (1)

It was in a large measure the liberal language of these court decisions following the Northern Securities Case which prompted Congress to enact Section 7 of the Clayton Act of 1914 which was calculated to strengthen the law against the holding company device by prohibiting holding companies in restraint of trade and making them illegal when creating monopoly.

The resulting loss of charter business resulting from the insistence of the then Governor Woodrow Wilson in 1913 that the power of stock ownership be eliminated, served only to stimulate the legislation of the broadest of powers in 1917. Other states in order not to lose incorporation and annual franchise fees, began a "race of laxity," as it is characterized by Justice Brandeis in 288 U. S. 217, to grant liberal incorporation privileges.

Since the Clayton Act of 1914, the holding company has been used chiefly for investment and financing purposes, controlling large aggregation of companies which are not directly competitors.

Between 1925 and 1930, holding company organizations have played important parts in the electric and gas utility, railway, industrial investment, and banking fields.

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(1) JEROME FRANK, LAW AND THE MODERN MIND, p.23





## V Comparisons with other types of corporate combinations.

We have defined the holding company and have briefly sketched its history. In order to understand it still better, it will be profitable to compare it with two other types of business combination--one, the trust, which it resembles; the other, the consolidation and merger from which it differs.

### A. The Trusts

A simple business trust is a form of business organization under which the legal title to property is vested in an individual trustee or trustees. The property is managed by them in the interest of former title holders who become beneficiaries. The trustees become not agents--as are partners--but as principals. They can make contracts, and can sue and be sued in their own names.

Under the common law, trustees may and do issue shares of beneficial interest, the capital of the trust being divided into these shares. These certificates are much like the stock certificates of a business corporation.

#### 1. The Intercorporate or Combination Trust

One of the variations of the simple business trust idea is found in the intercorporate or combination trust which was effected by organizing a board of trustees to





whom were transferred the stock certificates of the companies to be controlled. The stockholders of the corporation entering the trust received trust certificates in return. The trustees, holding the certificates of stock in the several corporations, elected the directors of these corporations and thus controlled their activities in accordance with a common policy as effectively as if the corporation were a single company.(1)

The advantage of this form of trust was that it was not an incorporated body under statute law. However, its life was short for the courts declared it an illegal extension of the common law trust principle.(2)

The combination trust, being an agreement between a group of individual trustees and a group of corporations affect the latter in that by implication they give up their autonomy and so act "ultra vires"; beyond their power in so far that it involves dealings between corporations resulting in partnerships between them. A holding company is duly authorized to deal in stocks of other companies; therefore, its acts in this respect are legal, whereas, the trust, in the eyes of the law, is not.

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(1) FINNEY, PRINCIPLES OF ACCOUNTING, Vol. 2, Chap. 47 p.2

(2) BYE & HEWITT, APPLIED ECONOMICS, p.89





## 2. The Voting Trust

The voting trust is "a kind of special express trust, which may be defined as a form of organization in which holdings of stock are combined by placing them in the hands of trustees to be voted in a stipulated manner." (1) A voting trust agreement is entered into, and stock certificates transferred to a board of trustees. In return, the trustees issue trust certificates or negotiable trust receipts.

All stockholder's rights except voting remain the same. The trustees collect the dividends and are bound to pay them over to the holders of the trust receipts.

Unified voting is the object of voting trusts, and the ownership of property is not vested in the trustees; they are trustees of management and not of property.

Its chief purposes are to carry out a judicial decree, to insure control, and in cases of reorganization.

This type of trust is legal and is undoubtedly legitimate when used reasonably. The only limits to the legality are that they must be for legal objects and not discriminatory against other stockholders; they must be formed for a reasonable duration of time, preferably not

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(1) HANEY, op. cit., p.134

(2) LINCOLN, APPLIED BUSINESS FINANCE, p.76





for a longer period than the life of a proxy; and that they should be open to all stockholders desiring to enter.

### 3. Massachusetts Trusts

The Massachusetts Trust or voluntary association is, "an association of persons with a combined capital represented by transferable shares for the purpose of carrying on a common project for gain." (1) The organization is created by filing with the properly constituted state authority a declaration of trust or indenture. By this form of organization, property is transferred to a board of trustees. Transferable certificates of ownership can be bought and sold after the manner of ordinary stock certificates.

These securities holding trusts have been formed in some states which do not authorize corporations to hold stock of other corporations, especially where the law prohibits the consolidation of public service corporations. This is true of Massachusetts electric railway companies and gas companies. The procedure is simply to put a majority of these stocks of several companies into the hands of trustees who then issue certificates in any amount desired.

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(1) LINCOLN, APPLIED BUSINESS FINANCE, p.76





They are virtually holding corporations, but are not subject to the law regulating corporations. Their legality may be questioned, according to Haney.(1)

From the viewpoint of economics, there is very little difference between the holding company and the trust. The chief difference exists in their standing at court. To change a trust to a holding company, a process illustrated by the history of the Standard Oil Company, it is only necessary (1) to substitute the stock of the holding company for the certificates of the trust, (2) to substitute the board of directors of a corporation for a board of trustees, and (3) to substitute a permanent transfer of stock or ownership for the trust relation.

#### 4. Investment Trust

An Investment Trust or Investment Company is formed purely for investment purposes and its essential function consists of the purchase and sale of stocks and bonds, and, in some cases, property. The company derives its income almost entirely from interest and dividends on the securities it holds; from syndicate profits, where it participates in syndicate underwriting; and from profits on the purchase and sale of securities. It does not attempt to manage the companies whose securities it owns. It buys securities

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(1) HANEY, op. cit., p.134





as an investor would do and without any purpose of determining the policy of the management.(1)

It differs from any holding company including the investment holding company, in that (1) it does not properly become interested in any one company that it cannot immediately withdraw its investment; and (2) its management recognizes some degree of fiduciary responsibility to a relatively large number of investors in its securities. Investment trusts properly seek safety of principle and a reasonable and continuous income through diversification; and they avoid control, management or financing responsibilities.

However, it appears that holding companies, although they differ from the investment trust, can, with slight changes, transform themselves into the legal semblance of investment trusts.

#### B. Consolidation and Merger

The last stage of combinations and the one to which all others lead, in the opinion of Professor Taussig, is the great or giant corporation.(2) The holding company tends to develop into it, its subsidiaries being deprived of their nominal independence, and the shareholders being direct shareholders in the single company.

- (1) WALTER M. W. SPLAWN, HEARINGS BEFORE THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, HOUSE OF REPRESENTATIVES, 72nd CONGRESS, First Session, on H. R. 9059, p.5  
 (2) TAUSSIG, PRINCIPLES OF ECONOMICS, p.443





There are two types, the merger and the consolidation. "By merger is meant the transfer of the assets of one or more corporations to another corporation under special statutory power, whereby the latter corporation, a single legal entity containing within itself the corporate life of all its constituents, remains as a single and sole owner of the combined assets....It is distinguished from other forms, first, by the fact that one of the constituent corporations retains its existence; and, second, by the fact that all the other corporations automatically disappear." (1)

"Amalgamation or statutory consolidation refers to a combination of the assets of two or more corporations under special statutory power, whereby all the amalgamating corporations are dissolved and one newly created corporation takes over the sum total of the assets. It is distinguished from a merger by the fact that all the old corporations disappear and a new corporate entity takes its place." (2)

The difference between the form of organization above described and the holding company is fairly obvious. The holding company retains separate existence of the combined organization and controls them by voting the stock. It can not formally act for the constituent companies independent of their directors. It is at most a partial or temporary consolidation.

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(1) BONBRIGHT AND MEANS, op. cit., p.27

(2) Ibid





We may list below the chief though by no means the only reasons which dictate a resort to mere stock control, rather than an outright fusion:

1. Ease of organizing the Combination.
2. Ease of Retaining Control through Stock Pyramiding.
3. Legal Advantage of the Holding Company.
4. Secrecy of the fact of the combination and of its financial accounts and operation.
5. Freedom from governmental regulation.
6. Decentralization of management.
7. Insulation of liabilities to creditors.
8. Ease of divorcing the properties.(1)

However, it can also be said that most of the very characteristics that favor the holding company in certain aspects at the same time militate against this form of organization in other aspects.

#### I. Ease of Organizing

No form of combination of anything like the stability and permanence of the holding company is organized with such facility.(2) Its first advantage, therefore, is facility of promotion.

The promoters of the holding company can more readily procure the necessary stockholders' votes and the necessary financing than any other form of consolidation.

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(1) ADAPTED FROM BONBRIGHT AND MEANS, op. cit., p.30

(2) HANEY, op. cit. p.269





Because of the generally greater ease of acquiring an interest in a company's stock than in purchasing its assets, and the possibility of acquiring control by securing a majority of the stock, it is a common practice to expand by purchase of securities rather than by securing direct legal title of the assets.(1) The same consideration may also apply and account for the continuance of the corporation rather than subsequently winding up its affairs and closing it out.

If an attempt were made to buy the subsidiary companies outright it might be rendered futile by the unwillingness of a few individuals to surrender the separate existence of the organizations in which they are interested. The formation of a holding company requires no consent on the part of the stockholders of the subsidiary companies, for the promoters may buy up stock in the open market until they get the controlling interest.

"Aside from the problem of securing the necessary voting power, the financier faces a far easier and less expensive task in financing a combination through a holding company than in financing a fusion. In the former case, all that is necessary is to exchange the securities of the holding company for the controlling stocks of the subsidiary

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(1) REPORT ON PIPE LINES, HOUSE OF REPRESENTATIVES,  
72nd Congress, p.XLV





companies. In the latter case, on the other hand, there must be an exchange of all the stock of the subsidiary companies for the stocks of the merged or amalgamated company. Sometimes, arrangements must be made to fund or refund the bonded debt.....The counsel fees and underwriting fees of effecting a complete fusion may alone run into the millions."(1)

However, the very ease of organizing and financing the combination suggests that the financial structure, when once set up, <sup>most times</sup> is likely to be less sound than that of the single, merged company.

## 2. Maintenance of Control

By all means the most important advantage of the holding company lies in the ease in which it may be used to concentrate and maintain control.(2) In the first place, only a majority of the voting stock of each subsidiary company need be secured in order to make control by the holding company effective, and even the purchase of less than the majority of these stocks may be sufficient for "working control." With the merger and amalgamation, on the other hand, the assenting vote of the stipulated majority of the shareholders (often including non-voting stockholders and sometimes extending to bondholders) of each company, generally a two-thirds majority, is required by state law. Moreover,

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(1) BONBRIGHT AND MEANS, op. cit. p.30 and 31

(2) Ibid, p.45





a dissenting minority may hold up a merger, either by challenging the fairness of the plan in the courts, or by insisting on their right to an appraised valuation of their shares and to a cash payment. No such embarrassment stands in the way of purchase of a controlling interest in a subsidiary company.(1)

A financial shortcoming of the holding company arises from the concentration of control. While a top heavy superstructure arising from the piling up of a series of its own securities on top of the securities of its subsidiary may please a management that is interested in maintaining control by ownership of the thinnest possible equity, it must displease any management that is interested in the financial integrity of the system rather than in the opportunity of stock jobbing profits.(2)

### 3. Legal Advantage

Business men sometimes prefer the holding company because legal obstacles would make fusion impossible or at least difficult to effect.(3) These obstacles may be due to the restrictive provisions of a charter or to state laws restricting the business of foreign corporations, or to state or federal laws preventing particular types of enterprises, such as railroads, from engaging in other forms of enterprise, or restrictions imposed by earlier mortgage, so drawn

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(1) BONBRIGHT AND MEANS, op. cit., pg.30

(2) Ibid, p.46 and 47

(3) BONNEVILLE, op. cit., p.274





together under the general control and supervision of the holding company; but the more detailed problems of organization as well as many of the larger questions of policy, may be assigned to the directors and officers of each separate subsidiary company."(1)

There are many advantages in decentralization. It may effect unified management while preserving the individuality and initiative of constituent organizations. Business enterprise, after reaching a certain size, may become inefficient and may lack the personal touch of the executives of the smaller company. Also, operating considerations may dictate the continuance of a separate corporate personality especially where the new company is engaged in a local business, or a business different from that of the parent company. Then, too, better results are anticipated from the placing of responsibility on officers and directors of subsidiary companies than by disrupting the organization. In some cases, companies are newly organized to take over certain branches of work in an effort to decentralize operations and at the same time centralize responsibilities.

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(1) BONBRIGHT AND MEANS, op. cit., p.40





While the holding company undoubtedly facilitates the policy of decentralization, its importance and significance may be easily exaggerated.(1) Decentralization is by no means desired in all cases.

#### 7. Insulation of liabilities to Credition

"Although a holding company may so completely dominate its subsidiaries that all the properties really form one great operating and financial system, each subsidiary none the less retains its separate corporate existence, and this legal separation is not often disregarded by the courts. In some respects....a separation of this kind is a source of annoyance to the interests that control the entire system. In other respects, however, it is a source of advantage, and one of these advantages lies in the insulation of each corporation from the creditor liabilities imposed upon all of the other constituent companies."(2)

#### 8. Divorcement of Properties

The final basis of comparison of the holding company and outright fusion, is the relative ease of undoing the combination if later events should show it desirable. Almost any consolidation of companies under a single control and management is necessarily in the nature of an experiment at the outset. Bonbright and Means claim that a fusion of

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(1) BONBRIGHT AND MEANS, loc. cit.

(2) Ibid, p.47 and p.48





all the constituent companies into a single corporation makes it extremely difficult to break up the system into its component parts. A combination by means of a holding company, however, makes a subsequent separation of the subsidiaries relatively easy, especially in the earlier stages of the holding company's existence. They feel that the fact that a system made up of holding companies can be so conveniently broken up if the controlling interests so desire, suggests that it may be in danger of being broken up despite the wishes of the people in control.<sup>(1)</sup>

*not true  
subject by  
political*

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(1) BONBRIGHT AND MEANS, op. cit., pp.48 and 49





## PART II.

## THE UTILITY ORGANIZATION

I. The Public Utility

Before proceeding to a discussion of specific phases of public utility holding company activity, it will be desirable to discuss the characteristics which distinguish public utilities from other industries as a basis of comparison between the public utility and the public utility holding company.

A public utility, in the legal sense of the term, means "an organization which supplies the public with certain types of essential service held to be subject to a peculiar kind of public regulation. The supply of water, gas, electricity, and transportation has been included by the courts among the services that are in the nature of a public utility." (1)

It has been defined by Bye and Hewett as "a group of industries whose monopoly position is so secure, and which controls necessities so important to the people that their prices have long been subject to regulation by the public authorities." (2)

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(1) BONBRIGHT AND MEANS, op, cit. p.201  
 (2) APPLIED ECONOMICS, p.267





## B.Characteristics

In early English law, there were certain callings, such as inn-keeping, operating a ferry and transporting merchandise, which the courts declared were "affected with a public interest" and which might, therefore, be controlled by a public authority.(1)

Neither the courts nor the commentators have set forth the doctrine of public interest with sufficient definiteness to enable us to state what attributes will cause an industry to be classed as a public utility(2) but certain broad features which are usually characteristic of such enterprises may be described:

They are affected with a "public interest", they are monopolies, they have special legal privileges, they are public servants and they are subject to regulation.(3)

"Private property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large." (4) While it is true that all business is charged in some way or other with a public interest (5) these companies supply commodities or service which are closely associated with public

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(1) ROOSEVELT, LOOKING FORWARD, p.140

(2) NEW STATE ICE CO. vs LIEBMANN 285 U. S. 262-(1932)

(3) BYE & HEWETT, op. cit. p.428

(4) MUNN vs ILLINOIS 94 U. S. 113 (1876)

(5) NEW STATE ICE CO. vs LIEBMANN, loc. cit.





welfare.

The second characteristic of the public utility is that it operates under conditions which tend towards monopoly.(1) This is sometimes referred to as their semi-monopolistic character.

It is quite desirable that they should be regarded as natural monopolies in order to prevent a duplication of the large plant and fixed investment so necessary in industries of this type. In those businesses where interest and depreciation charges contribute a large element in the cost of production, experience has taught that the financial burdens incident to unnecessary duplication of facilities may result in high rates and poor service.

Public convenience and economic necessity may demand that public service company enjoy monopolistic privileges not only because of the excessive cost of duplicating plant and equipment, but also because these industries operate under the economic law of increasing returns. We are willing to accept monopoly and combination because we expect to obtain better service at a lower cost.

Because the interests of the entire community are directly concerned in the manner which it is operated, the public service company is almost invariably the re-

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(1) BADGER, INVESTMENT PRINCIPLES AND PRACTICES, p.347





recipient of special privileges, in the form of the right of eminent domain, the right to use the highways in special ways, or the grant of subsidies in money and other assets.

They are recognized as public servants. People are peculiarly dependent upon the railroads for their means of existence and are compelled to patronize them. Similarly the street railways, electric, gas, and telephone services are so integral a part of domestic and business life that the public is coming to be particularly dependent on them. The same can be said of other businesses which fall under the heading of public utilities.

The services they perform are a legitimate function of the state. They must provide adequate services and facilities to all who apply, at reasonable rates, without discrimination.(1)

They are subject to regulation. The public right to regulate them is based on the common law, strengthened by statutes and court decisions.(2) The legal basis of control comes from the government character of the services rendered, the grant of special privileges, or because of the monopoly characteristics of the industry. They are

(1) FEDERAL TRADE COMMISSION, op. cit.

(2) MUNN vs. ILLINOIS, loc. cit.

NEBBIA vs. N. Y. 291, U. S. 502 (1934)





subject to regulation through the common law, by the franchise or certificate of necessity, by legislative enactment, and by commissions. The method of public control understood by the term regulation concedes monopoly as absolutely essential in the interests of the consumer.(1)

Other distinguishing characteristics of public utilities is the need for peak load producing capacity in the case of railroads and electric power utilities, and for storage capacity in the case of gas and water companies.

### C. Types of Service

There are certain types of service which are recognized in the public utility concept. They are common carriers; service incidental to transportation; communication; power, heat, light, and refrigeration; and water facilities.

The transportation industry is the largest public utility industry in the United States.(2) The railroads of this country were organized under charters as common carriers, which allows them to render services only and prohibits sale of anything, even their own coal.(3)

The electric and gas utility is the second largest public utility industry in the United States.(4) It differs from the railroad companies in that the latter were organized under charters as common carriers while the

(1) PUBLIC UTILITIES FORTNIGHTLY, May 11, 1936, p.653

(2) JOHN J. BICKLEY, as reported in the "Christian Science Monitor," March 24, 1936

(3) HEARINGS ON H. R. 5423, HOUSE OF REPRESENTATIVES, SEVENTY-FOURTH CONGRESS, p.503

(4) JOHN J. BICKLEY, loc. cit.





electric and gas utilities were not.(1) It also differs by being essentially a local or state industry, whereas the latter is primarily interstate.

The telephone industry is the third largest public utility industry in the United States.(2) In comparison with the other utilities, it resembles the railroad industry because of its interstate character.

In current investment parlance, the term public utility is limited to light and power, both gas and electricity, companies or organizations supplying either or both of these services in addition to traction.(3) The term does not include companies engaged in street railroad, water, telephone and telegraph business, unless these services are merely incidental to the electric or gas business. Therefore, in order to limit the amount of material in this study, I will endeavor to confine the problem to the gas and electric utility. Other reasons for this limitation will be found in comparing the railroad and telephone holding companies with the gas and electric holding companies.

(1) H. R. 5423, op. cit., p.502

(2) JOHN J. BICKLEY, loc. cit.

(3) JOSEPH EDWARDS BAKER, TESTS OF A PUBLIC UTILITY BOND, p.18





## II. The Public Utility Holding Company

It is in the utility field that the holding company has had its highest degree of development and it is in this field that it has had its severest criticism.

### A. Definition

The public utility holding company, is thus defined by Professor Dewey:-

"In its simplest form, the public utility holding company consists of a corporation organized under the laws of some state which permits its corporation to hold the securities of other corporations in its treasury. The holding company acquires a control in the equities of local utilities, and through the ownership of these equities exerts direct financial and management control over the operation of the local utilities." (1)

According to the Federal Trade Commission,

"A public utility holding company does not engage usually in supplying electric or gas service to the public, but owns principally the voting stocks giving control of companies which do own the generating and manufacturing plants and distribution facilities for rendering such services. Through this ownership of voting stock the holding company names the directors and officers of the operating companies through whom it dictates the policies of these companies." (2)

The effect practically is a consolidation of the separate companies.(3)

### B. History

"The early history of the public utility holding company, although it does not extend back further than

(1) FINANCIAL POLICY OF CORPORATIONS, p.856

(2) FEDERAL TRADE COMMISSION, REPORT ON PUBLIC UTILITIES, SENATE DOCUMENT 92, No. 72 A, p.179

(3) LINCOLN LIBRARY OF ESSENTIAL INFORMATION, op.cit.p.1265





the eighties is very difficult to trace. The first corporation of its kind analgous to the modern holding company was the predecessor of the present organization known as the United Gas Improvement Company." (1) The old United Gas Improvement Company was incorporated in 1882 as a Pennsylvania corporation, for the purpose of introducing improvements in the gas industry.(2) As it found great difficulty in introducing improvements, it at first leased gas works in various parts of the United States and subsequently acquired their stocks, beginning around 1884.(3) At first the stocks of these gas companies acquired were placed in the hands of a trustee, as the general laws of Pennsylvania did not permit one corporation to hold the securities of another corporation. As this procedure was indirect and cumbersome, the company acquired the charter of the Union Contract Company, and old charter granted by a special act of the Commonwealth of Pennsylvania in 1870(4) which permitted, among other things, the corporation to purchase and own securities of other corporations.(5) The name of the Union Company was changed in 1888 to the United Gas Improvement Company. The new United Gas Improvement Company then acquired the assets of the old United Gas Improvement Company, by exchange of stock and also the shares of

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(1) DEWEY, op. cit., p.858

(2) NASH, op. cit., p.406

(3) DEWEY, op. cit., p.859

(4) CONGRESSIONAL RECORD, JUNE 28, 1935, p.10771

(5) DEWING, op. cit., pg.860-861





gas companies held in the interest of the latter by trustees.(1)

The success of this company as a holding company for the stock of local utilities attracted others. The second, in 1890, was the North American Company, a reorganization of the old Oregon and Transcontinental Company.(2) The plan of the directors of this company was to develop, intensively, the electric business in a single locality and secure profits for the holding company through unified control and economical operation of all the electric utilities of a single, relatively confined, but thickly populated area.(3)

In 1900, the American Light and Traction Company was organized for the purpose of acquiring and operating local utilities.(4)

Later, certain great electric supply houses in developing a market for their goods undertook to encourage and even to finance local companies in many different parts of the country.(5) That practice resulted in the acceptance of securities as part or in whole payment of obligations and later led to formation of holding companies to acquire the local properties.(6) For a time these holding companies

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(1) DEWING, op. cit., p.861

(2) NASH, loc. cit.

(3) DEWING, op. cit., p.862

(4) IBID

(5) SEVENTY THIRD CONGRESS, HOUSE REPORT #8273, Part 2. Page VI

(6) RUGGLES, PROBLEMS IN PUBLIC UTILITY ECONOMICS AND MANAGEMENT, p.192





were really subsidiaries or affiliates of the great electric supply house. Some of these holding companies developed very efficient service organizations which were incorporated as subsidiary companies.

At first these electrical manufacturers created a collateral trust, pledging a miscellaneous lot of public utility securities as collateral for an issue of bonds of the manufacturing company.(1) Sometimes the trust was incorporated and the stocks of the public utilities were given to investors as a bonus.

These trusts were the beginning of a system of marketing the securities of local public utilities thru the sale of securities of widely known holding companies. This plan also made available to the public diversified securities issued by many companies operating in different communities and in different geographical areas.

In time, promoters and speculators came into the field and set up holding companies to share in the profits which the older companies demonstrated as possible. During the highly speculative period preceeding 1929, holding companies competed with each other for control of operating properties.(2)

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(1) RUGGLES, op. cit., pg.193

(2) HOUSE REPORT, #827, loc. cit.





Until after the World War, the holding company had not made a favorable impression as a whole, but that might be attributed to the development period.(1) After the war, with the immense growth of utilities, the holding company achieved prosperity by leaps and bounds. ?

In the study made by the Committee on Interstate and Foreign Commerce, it was found of fifty-seven holding companies, twelve were chartered between 1906 and 1912, four between 1912 and 1922, and forty-one between 1923 and 1929.(2)

#### 1. Comparison with Industrials

The holding company in the public utility field differs from the holding company in the industrial field in three directions.

Competition is still the source of reliance for the control of price, quantity, and quality of output in the industrial field; whereas, monopoly is the sound form of organization from the economic viewpoint in the utility field. The holding company in the industrial field, therefore, has been treated as a part of the trust problem, while the public utility holding company has been treated as a phase of utility regulation.

In the second place, the individual members of a keenly competitive industry cannot add to their earning power by corporate devices. In the regulated industries, such as

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(1) FEDERAL TRADE COMMISSION, op. cit., p.857

(2) HEARINGS BEFORE THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE ON PUBLIC UTILITY HOLDING COMPANIES, p.69





the public utilities, however, a gain is possible. In the industrial holding companies, there has grown up no such system of pyramiding and subdividing of investment as found in the utility groups.(1)

In the third place, industrials and utility holding companies differ in that subsidiaries of the utility holding companies are usually operating properties of similar characteristics with few opportunities for the vertical integration found in industrial groups.(2)

## 2. Dominance in Utility Field

According to the Federal Trade Commission, holding companies have dominated the privately owned electric utility industry for a number of years.(3)

The earliest study of control in the electric utility industry was made by the United States Bureau of Corporations, a predecessor of the Federal Trade Commission 1916, and concerned itself with developed water power.

In 1914, the public utility holding company in the electrical utility field was not an important factor. Local large corporations and management companies dominated the industry.(4)

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(1) H.R. 827, op. cit., p.362

(2) NASH, op. cit., p.422

(3) FEDERAL TRADE COMMISSION, REPORT op. cit., p.34

(4) IBID, p.36





The first survey of the activities of the public utility holding companies was made in 1915 by the United States Department of Agriculture. At that time it was found that about two thirds of the output of electric power companies was produced by 85 large companies or groups of companies.(1)

In 1924 holding companies controlled about 65 per cent of the operating electric utility industry.(2) The companies in the General Electric Company group had approximately 13 per cent of the industry, 6 other large holding company groups 28 per cent and other holding company groups approximately 24 per cent.(3)

The growth of the utility holding company movement attracted unceasing public attention and occasional fears of undue concentration and domination in the electric power and industry as early as 1925.(4) On February 8, 1925, a comprehensive investigation to determine the extent to which the General Electric Company and other interests were exercising control over the production and distribution of electric energy and electrical equipment was authorized by the United States Senate.(5)

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(1) NASH, op. cit., p.407

(2) REPORT OF THE NATIONAL POWER POLICY COMMITTEE ON PUBLIC UTILITY HOLDING COMPANIES

(3) FEDERAL TRADE COMMISSION, loc. cit.

(4) NASH, loc. cit.

(5) RUGGLES, op. cit., p. 195





# Interest in the Electric Bond & Share Company

According to the Senate report, in 1924, neither the General Electric Company nor any other single power interest, or group of allied power interests, substantially monopolized or controlled the generation, transmission, and sale of electricity in the United States although there is monopolization within certain states and lesser territorial areas tending to transcend state boundaries.(1)

During the years from 1923 to 1929, holding companies already large and ungainly were still expanding in hope through mere size that they could gain in the supposedly increasing prosperity.(2)

H. S. Raushenbush estimated that in 1930 one half of the electric power generated by the large power companies was in the houses of three great holding company groups; that two thirds of the electrical energy was controlled in six groups, and over 90% by 15 groups.(3)

In 1932, 13 large holding company groups controlled three fourths of the entirely private owned electric utility industry concentrated in the hands of the three largest groups at that time, United Corporation, Electric Bond & Share and Insull (4) which between themselves controlled 40% of that industry.(5) Even these three were not totally independent,(6) United Corporation having a stock in-

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(1) SENATE DOCUMENT # 213-pg.50 and 51

(2) DEWEY, op. cit. pg.893

(3) LAIDLER, CONCENTRATION OF CONTROL IN INDUSTRY,pg 152 &153

(4) SENATOR WHEELER CONGRESSIONAL RECORD,(MARCH 28,1935)p.4774

(5) SENATOR EICHER, HEARINGS ON H.R.,1318,op.cit.p.49

(6) REPORT OF THE NATIONAL POWER POLICY COMMITTEE,loc.cit.





interest in the Electric Bond & Share Company.

In the years between 1930 to 1934, many holding companies failed. Others were broken into homogeneous units by fear of impending failure. The influence of the depression has brought the evidence of weakness of mere size without coordinated control.(1) On May 11, 1936, the Federal Power Commission reported that 50% of the electric utility industry were controlled by nine large holding company systems and that 90% of the industry was controlled by 57 principal systems.(2)

According to the New York Times, in 1936 12 systems of holding companies got 53% of the total revenue from the sale of energy to consumers.(3)

The rise to power of the holding company in the gas utility industry has no less been startling than in the field of electricity. In 1932, eleven holding company systems controlled 80.29 per cent of the total mileage of natural-gas trunk pipe lines, on which the gas fields almost completely depend for the marketing of their product. In the field of gas production, distinction should be made between manufactured and natural gas operations. In the latter field there are three types of companies; covering the function of

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- (1) DEWING, op. cit. p.893
  - (2) NEWS ITEM IN CHRISTIAN SCIENCE MONITOR, MAY 11, 1936
  - (3) NEW YORK TIMES, SEPTEMBER 27, 1936 P.10E. ARTICLE BY HAROLD B. HINTON.





production, transmission and distribution respectively. In this field the holding company may control all three types of corporations, operate them as one system, fixing the prices.(1)

#### D. Types

According to Bonbright and Means, there are four types of holding company combination:

1. The combination of competing or adjacent properties.
2. The combination of widely separated utilities, performing the same or different services, and having no physical inter-connection.
3. The combination of two or more utilities operating in the same territory, but performing different services.
4. The combination of utility enterprises with non-utility enterprises.(2)

Each has its advantages and disadvantages. The combination of competing or adjacent properties in an industry subject to regulation is of economic good in that there is elimination of wasteful competition and there is the technical economies of large-scale production and distribution. It is the earliest form of combination.

The combination of adjacent utility properties carries with it many advantages beyond the gain resulting in elimination of

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(1) FEDERAL TRADE COMMISSION, op. cit. p.852

(2) Op. cit., pg.188





The combination of more than one type of utility service in the same territory has to meet the problem of competition and large scale production. There has been developed greater technical efficiency in the use of steam and hydro-generating plants, long distance transmission lines and the improved load factor which may be secured by a tie-up of residential, commercial and industrial users.

The most characteristic form of the public utility holding company is a centralized control of widely scattered utility enterprises.(1) The advantage that may result from this type are 1) improvement of management, 2) better terms for purchase of supplies, and 3) improved financial status and stability of securities.

According to the Committee on the Public Utility Bill of the Business Advisory Council of the Department of Commerce:

"The holding company ownership of scattered properties performs for the financial element of the cost of power what the physical connection of operations performs for the physical elements of the cost of power. When both are present, the result is cumulative."

(2)

However, as the size of the operating company grows, the advantage of this form of centralized management operating at a distance decreases.

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(1) BONBRIGHT AND MEANS, op. cit., pg.193

(2) APRIL 30,1935, in the CONGRESSIONAL RECORD, JUNE 6,1935.

(1) DEWEY, op. cit., p.722, footnote "b"

(2) FEDERAL TRADE COMMISSION, op. cit. p.82

(3) Ibid, p.24 to p.119





The combination of more than one type of utility service in the same territory has to meet the problem of competition between these services. There is less advantage of unified service than in the other two combinations studied. The effect on the control of rates where one type of utility is more profitable than the other has attracted the attention of public service commissions.

The fourth type of utility combination would include a combination of electric utility with cotton cloth mills, paper mills, banks, and hotels.(1) The disadvantage in this type is that the utilities may be forced to support non-utility losses.

According to the Federal Trade Commission, there are two more or less well-defined types of holding company groups in theory but no sharp separation between the types in actual practice.(2)

There is the diversified investment type and the large connected type. The former does not consist of one continuous chain or net-work in contiguous territory, but are utilities that are separated geographically.

The latter type of holding company groups is one where the utilities form on contiguous net-work.

A description of the types is given in the Summary Report of the Federal Trade Commission.(3)

(1) DEWEY, op. cit., p.702, footnote "b"

(2) FEDERAL TRADE COMMISSION, op. cit. p.84

(3) Ibid, p.84 to p.119





### E. Scope

Of 487 holding companies listed on the stock exchange in 1928, 46 represented railroads, 36 represented "utilities" and 407 represented "industrials".(1) While on the face of these figures, the railroads and "utilities" seem less important, the fact that they are subject to regulation of varying degrees, allows us to examine them more closely than the "industrials".

### F. Railroads

In the electric and gas utility field, the pure holding company has become the dominant form of combination. In the railway field, with a certain few important exceptions, it still plays an subordinate role.(2) This distinction is vital; for a parent railway or utility company, being an operating company is subject to direct supervision of state and federal commissions while a utility holding company, under existing laws, is comparatively free from regulation.

There are three reasons which largely account for the striking difference between corporate organizations of gas and electric utilities and the railroads: first, the more recent developments of the former business, second, the relatively small size of each "utility" operating unit and third, the freedom of financial control enjoyed by the railroad operating companies prior to the transportation Act of 1920.

(1) SENATOR DICKINSON, CONGRESSIONAL RECORD, JUNE 6, 1935, p. 9083.

(2) BONBRIGHT AND MEANS, op. cit. pg. 224





In the railway holding company field we find the Alleghany Corporation, the Pennroad Corporation and the Chesapeake Corporation.(1) These are holding companies in the guise of investment companies. (2) Possible speculative gains on security holdings were hoped for, but a strong motive was to strengthen control and build up great systems without the sanction of regulation by the Interstate Commerce Commission.(3) With the coming of the Transportation Act, holding companies have been formed in a desire to escape regulation of that act,(4) but the Holding Company Act and the Transportation Act of 1933 were passed in an endeavor to check this new growth.(5)

## 2. Communication

Of the three largest groups of public utilities, no group of an entire industry is so completely dominated by a single holding company or ownership group as in the case of the telephone service. Most of the important telephone companies in the United States have been brought together in a nationwide system under the direction of the American Telephone and Telegraph Company (6) a holding company of two dozen operating concerns within the Bell interests.(7)

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(1) REGULATION OF STOCK OWNERSHIP IN RAILROADS, REPORT 2789  
71st. Cong. 3rd. Session, pg.878

(2) HANEY, op. cit., pg.258

(3) IBID, pg.255

(4) REGULATION OF STOCK OWNERSHIP IN RAILROADS, loc. cit.

(5) HEARINGS BEFORE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
Seventy-Fourth Congress, op. cit., p.136

(6) MOSHER AND CRAWFORD, PUBLIC UTILITY REGULATION, pg. 326

(7) LAIDLER, op. cit. p.91





The telephone, telegraph and radio companies differ from the gas and electric utility holding companies in that the former, like the railroads, are subject to both State and Federal regulation (1) whereas the latter is subject only to State regulation, if any, up to 1935.

In contrast to the electric power industry, the telephone business in the United States shows greater concentration of control.(2) In 1931, the Bell system owned and operated more than 75% of the telephones of the United States with the balance connected with the Bell System under contract whereby complete intercommunication is possible. Only 103,000 of a total of 21,200,000 telephones in the United States in 1931 were independent and non-connecting.(3)

In 1936, the Federal Communications Commission found that The American Telephone and Telegraph Company was the top block in a structure of 200 corporations, controlling  $93\frac{3}{4}$  per cent of the telephone investment in the United States, 85% of all the telephone instruments and 97% of the long distance voice.  
(4)

Three principle facts were brought out in an investigation by the Federal Communications Commission:(5) 1. The Bell

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(1) MOSHER AND CRAWFORD, op. cit., pg.369

(2) NASH, OP. CIT. pg.410

(3) IBID, pg. 411

(4) CHRISTIAN SCIENCE MONITOR, March 24,1936

(5) IBID, April 6,1936





system holds admitted a "virtual monopoly" of telephone communications in the United States.

2. Its ramifications due to inventive and research work extend into many fields outside telephone service.

3. Its legal department keeps close watch on legislation.

It is generally agreed that the holding company in the telephone field is of economic and social value in the industrial life of this nation. No doubt it is a fine example of the holding company in the utility field.

### 3. Electric & Gas

In the electric light and power industry, holding company control has been quite extended, but that control thus far is divided by a number of financial groups and, as yet, there is no movement towards a single nation wide holding company, comparable in its field to the American Telephone and Telegraph Company.

The development of the holding company in this industry is predominantly a development of the last decade - mostly from 1923 - 1930.(1)

Among groups of holding companies in this field, there is extreme diversity as to (1) financial magnitude, (2) business fields, (3) organization and (4) geographical extension.  
(2)

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(1) H. R. 827, op. cit., p.8

(2) IBID, PART 2, op. cit., pg.6

(1) DREYER, op. cit., p.876 and p.879

(2) FEDERAL TRADE COMMISSION, op. cit., p.118

(3) DREYER, op. cit., p.883





While the corporate form of organization is universal in this field, we find an individual entrepreneur, partnerships, trusteeships, lessees, as well as a superlatively complex examples of organizations involving various and devious combinations of corporations, Massachusetts Trusts and management contracts.

The problem is complicated by the fact that many companies are mixtures, having within their structures quasi-utilities, industrial plants and even hotels.(1)

#### F. Reasons for Formation

"The basis for the holding company in the gas and electric utility field lies, on the one hand, in certain economic needs of small operating companies for financial, engineering, and managerial services and, on the other hand, in the personal ambitions of the individuals who form the holding companies."(2) The two are not necessarily antagonistic.

Professor Dewey attributes four reasons for the justification of the public utility holding company. They are the technical, management, public relation, and financial advantages of this form of organization.(3)

##### 1. Economic

The holding company is necessary in the utility field from the economic viewpoint because of the technical efficiency of a centralized management of a number of companies.

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(1) DEWEY, op. cit., p.878 and p.879

(2) FEDERAL TRADE COMMISSION, op, cit., p.118

(3) DEWEY, op. cit., p.863





By reason of its ownership of a number of utilities, the holding company is able to employ men of far greater technical knowledge and ability than the comparative meagre resources of the single local utilities. Most utilities were operated during their early existence by local men who knew very little of the technique of the business, according to Professor Dewey.(1) Although these men soon learned the business, they were unfamiliar with the technique of the industry.

The holding company performs an economic function in that it is a mechanism for pooled services of management and engineering as well as other services such as engineering research and certain other scientific services which <sup>small</sup> no company can afford to carry on for itself.

A central organization can deal more intelligently and farsightedly with the public authorities and the customers than can the local organization, especially in the placing of contracts and the establishing of rates. The holding companies also render its subsidiaries assistance in the matter of new business, business policy, rate schedules and capital outlay schedules.(2) Perhaps the most conspicuous help of the holding company is the unprecedented flow of capital into the public utility industry,(3) making

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(1) DEWEY, op. cit., p.846

(2) Ibid, p.867

(3) REPORT OF THE COMMITTEE ON THE PUBLIC UTILITY HOLDING COMPANY BILL OF THE BUSINESS ADVISORY COUNCIL OF THE DEPARTMENT OF COMMERCE, April 30, 1935





possible extensions and improvements of service.

The outstanding problem of all public utilities, with the exception of Massachusetts, since the beginning of the century, has been the financial problem of obtaining capital. The technical advances of gas and electric mechanics have outstripped capital available to take advantage of these advances. In the presence of competition for capital both within and without the industry, that utility has fared best which had some financial support. That support has been given by the holding company.(1)

The main financial function claimed for the holding company is to assist in financing the needs of the subsidiary that serve relatively small cities and rural communities. The principal assistance is rendered through furnishing funds through purchase of common stock, and selling the preferred stock and bonds of the operating company to the investing public. However, in many cases, the fixed capital of many operating companies was written up to such an extent, and bonds and stocks sold to the public in such amounts, that the common stocks of operating companies were held by the holding company at little or no cost to it, according to the Federal Trade Commission.(2)

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(1) DEWEY, op, cit., p.870

(2) FEDERAL TRADE COMMISSION, op. cit., p.120





The second financial function is that of temporary financing the current capital needs of the subsidiary pending permanent financing. This is done through the process of paying supply bills for the operating company and of leaving in their treasuries the funds representing earned surplus available for dividends on their common stocks which are owned by the holding companies.(1)

The third financial function has been to furnish more or less temporary funds needed in senior security financing of operating companies when market conditions are unfavorable.

## 2. Personal

Electric and gas holding companies are also mechanisms whereby their organizers and their successors promote their own financial interests and careers. A number of leading electric and gas holding companies have each been dominated by a single individual or a small group of individuals. It furnishes the opportunity of working out a career, or assures him business by taking control of his clients, or reimburses him for an outlay made in the acquisition of securities, or offers him the opportunity to develop great power through the building of a great financial group, and offers him many opportunities for personal profit. Sometimes the occasion for the holding company formation is the accumulation of a

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(1) FEDERAL TRADE COMMISSION, op. cit., pg.120 and 121





mass of securities, or in the process of furnishing a resale market for the securities of clients, or in the process of manipulating the market for such securities. The prices paid for additional units in a system have been frequently run up out of reason by rivalry of contending systems in order to satisfy personal desires.

#### G. Advantageous development

David E. Lilienthal, now a member of the Tennessee Valley Authority, in an authoratative article in the Columbia Law Review in 1929 wrote: "The holding and management company has come upon the field, demonstrated its prowess and in a relatively few years changed the entire economic nature of the public utility industry."

#### 1. Operating companies

Holding company control and management of public utility operating companies has resulted in developments to the advantage of the operating company and is reflected in connected operations, large scale operations, and expert management, technically and commercially. These advantages appear in varying degrees as affected by volume of business, localities served, and possibilities for the development of the operating companies.(1)

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(1) FEDERAL TRADE COMMISSION, op. cit., p.834





The utility industry, especially in the electric and gas fields, has had a phase of free lance pioneering in which rapid development was facilitated by the holding company, the readiest means of bringing together many unconnected operations lying in a single and indifferent states into one connected unit of operation.(1) Such a grouping of adjacent communities connected by means of transmission lines, especially in the electric field, makes it possible to link the various independent power units into superpower systems. By combining steam and hydro-generating plants, the superpower systems can get the greatest benefit possible to the entire system. This interconnection is possible between operating companies of different ownerships, but owing to the inability of assessing the benefits, it is more satisfactory and more practical to have common ownership or one hundred per cent ownership of subsidiaries.(2)

On the other hand, there are examples of intergroup of electric power such as the Connecticut Valley Power Exchange, Safe Harbor, and others which do not depend primarily on the same management.

This interconnection of power companies and plants has resulted in the construction of more efficient central stations of large capacity with a lower cost of production as

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(1) NASH, op. cit., p.427

(2) REPORT OF BUSINESS ADVISORY COUNCIL, DEPARTMENT OF COMMERCE, loc. cit.





the demand for power increased, and as the marginal or sub-marginal power plants were abandoned. With connected operations, there is the broadest opportunity to use only the larger and more efficient plants and those with a lower cost of production. This development and interconnection has resulted in greater use of the facilities which have been constructed because of the demand. There has been an increase from two million kilowatts installation with an output of two billion kilowatt-hours in 1910 to a thirty-five million kilowatt of plant capacity with a production of nine billion kilowatts in 1930.(1)

Maintenance and prompt restoration of service in flood districts, hurricanes, and other calamities also demonstrate holding company advantage of connected operation and connected operation facilities.(2)

The improvements in the electric utility industry which include larger and more efficient generating units and improved transformers, has made it possible for the holding company to reduce investment per unit of capacity and costs per unit of energy produced in large-scale production.(3)

The economy due to the purchase of equipment arise from greater intelligence and from the economy resulting from large contracts with manufacturers. Economies are often possible in the purchase of standard equipment where

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- (1) HEARINGS BEFORE THE COMMITTEE OF INTERSTATE AND FOREIGN COMMERCE ON H. R. 5423, op. cit., p.271
  - (2) NATIONS' BUSINESS, January, 1936, p.36
  - (3) FEDERAL TRADE COMMISSION, op. cit. p.34





no discriminatory judgment is required. Pooling of orders often permits maximum "quantity" discounts. Centralization of the placing of insurance and the handling of claims by a specialist makes for lower premiums and more favorable settlements.

The smaller properties cannot afford to employ regularly and exclusively a high degree of administrative, financial, and technical skill. A large holding company can command and retain a capable trained staff available at all times and at comparatively small cost to its individual subsidiaries.(1)

The advantage of having marked technical skill to direct the general policy of a small company while the actual operations have to be left with an immature or partly trained local superintendent, has unquestionably worked out well in practice says Professor Dewey.(2) The administrative operation of any public utility consists of two fields of activity. The operator must determine the technical policies of the company, and he must attend to the day-to-day routine business. The former requires a broad knowledge of utility engineering, the product of a highly specialized technical training and wide experience; while the latter can be entrusted to a man of mediocre ability.(3)

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(1) NASH, op. cit., p.10

(2) FINANCIAL POLICY OF CORPORATIONS, op. cit. p.846

(3) Ibid





It has reduced the cost of borrowing money by better financing whereby money for improvements and expansions sometimes has been obtained at lower annual costs and easier terms, due to the broader field of operation and the larger volume of financing resulting from combining the capital requirements of a large number of corporations. (1)

The credit of the holding company is the credit of a going concern to which each new project is an extension. In comparison, the project is alone and in the eyes of the investor more speculative and thus would demand a higher return on the investment. (2)

## 2. Consumer

Advantageous developments, in the interest of consumers, which have resulted during the growth of the holding company in the public utility field may be classified as improvements due to widely extended service, improved service, lowered cost of service and increased use of appliances. (3)

There has been widely extended service, especially in natural gas and electric power fields, reaching many small communities, suburban areas, farms and isolated industrial operations.

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(1) FEDERAL TRADE COMMISSION, REPORT OF, op. cit. pg.838

(2) BUSINESS ADVISORY COUNCIL OF THE DEPARTMENT OF COMMERCE, op. cit.

(3) FEDERAL TRADE COMMISSION, op. cit. p.841





"We find a much improved service in dependability, regulation of voltage, adequacy to meet growing demands with little or no delay, all results of new investments and greater skill in construction and operation", says the Federal Trade Commission.(1)

During the last twenty-five years, with the exception of the war and immediate war period, there has been a decrease in the price to the consumer and an extremely low price to the large hydro-power user.(2) The latter reduction has been possible through a reduction in the cost of capital.(3)

With regard to lowered cost of service to the consumer, the Federal Trade Commission reports:-

"There may be a difference of opinion as to whether rates were reduced as fast or as far as they should have been, if based on fair calculation of all costs; but the records show what is known to everyone that the general levels of prices for utility service have tended to decline, owing primarily to lower operating costs." (4)

With regard to increased use of appliances, the Federal Trade Commission says:-

"While intensive methods designed primarily to sell appliances and thereby increase bills were used, they had the effect of bringing directly to the consumer knowledge of various devices and methods capable of increasing convenience, comfort and health and reducing cost of operations in the home or factory." (5)

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(1) FEDERAL TRADE COMMISSION, loc. cit.

(2) IBID

(3) BUSINESS ADVISORY COUNCIL OF THE DEPARTMENT OF COMMERCE

(4) FEDERAL TRADE COMMISSION, loc. cit.

(5) IBID





### 3. Investor

The holding company in the utility field has benefited the investor in three directions. It has made for the diversity in character of operating companies, it has reduced the cost of borrowing money and given its stockholders the advantage claimed for large scale business.

However, the Federal Trade Commission in its report to the U. S. Senate on Public Utility Corporations does not seem to be very much impressed by the benefits accruing to investors in this non-competitive field with its expectation of a reasonable return on investment.(1)

### H. Detrimental Developments

The holding company in the public utility field has been subject to many abuses which have resulted in developments detrimental to the interests of the operating companies, the consumer, the investor and the social policy.

The Federal Trade Commission summarizing investigation which began not under the "New Deal" but in 1928, and which consists of some 84 monthly reports,(2) charged utility holding companies or rather some of them, with having fostered many vices.(3)

There is disagreement as to how extensive and how serious these abuses have been, and it is fairly clear that they were representative of a minority, rather a majority of the industry. Yet it is plain that they have been

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(1) FEDERAL TRADE COMMISSION, op. cit. pg.857-858

(2) IBID, Senate Report on Utility Corporations Document No.92 84 B

(3) IBID, Report on Utility Corporations, No.72A pg.881-882





sufficient prevalent to put the whole industry in public disrepute and to warrant serious regulatory efforts to prevent the continuance or recurrence of these activities. While these practices have been lawful they have produced such undesirable results so as to require that they be outlawed for the future.

According to the Federal Trade Commission, the abuses of the holding company fall into two classes:

1) Unsound and /or needless financial structures and practices which are a detriment and frequently a menace to the investor or the consumer or both.

2) The milking of the operating companies thru the device of numerous forms of contracts and arrangements.(1)

1. Operating companies and consumer.

Since the management of the holding company and the subsidiary are identical, the accounting system used can make the separate interests of the subsidiaries subservient to the interest of the holding company, (2) and defeat the effective regulation of the operating company.(3) The operating companies are affected by, (a) upstream loans, (b) contracts, (c) write-ups, (d) inadequate depreciation provisions, (e) intercompany sales, and (f) manipulations affecting profits, (g) interlocking directors and trustees.

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(1) FEDERAL TRADE COMMISSION, REPORT ON UTILITY CORPORATION, NO.73 A. pg.64

(2) DEWEY, op. cit. p.880

(3) MOSHER & CRAWFORD, op. cit. p.351





a. Upstream loans

Professor Dewey points out that the most serious injury the holding company can do to the subsidiary is that of using the stronger credit of the subsidiary to bolster the weaker credit of the local company.(1) This is known as the upstream loan. The Federal Trade Commission claims that looking at the situation generally, neither upstream nor downstream loans form a large part of the outstanding indebtedness of holding or operating companies, the great mass of their obligations being held by the public.(2)

b. Service, sales and construction contracts.

It is through the service, sales and construction contracts that the holding company has "milked" the operating company by charges for services and commodities. Where these charges were not exorbitant or not excessive, they were questionable because these contracts were results of transactions not made at arm's length, but are decisions of the holding company itself sitting through representatives on both sides of the table. It is firmly established at law as seen in the decision of *Smith vs Illinois Bell Telephone Company* (282 U. S. 133) that there is no constitutional right to derive profit from a contract of this kind.

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(1) FINANCIAL POLICY OF CORPORATIONS, p.881

(2) FEDERAL TRADE COMMISSION, REPORT ON UTILITY CORPORATION, NO.72 A., pg. 856





The Federal Trade Commission in its report to the Senate on Utility Corporations makes the following comment on profit making arrangements:

"That the holding company making the charges absolutely controls the activities of the operating companies and of the servicing organization and are, in that respect, contracting with themselves; that not being public utilities, the holding companies are not subject to control in the form of either actual or potential competition from other servicing organizations or direct control by any public regulatory body in determining the fees charged; that fees for other service, to the extent that they include a profit, increase the expense of operation, and likewise tend to increase the rates payable by the consumer, and finally, that the profit element in fees furnishes obviously a temptation to increase the amount of special services rendered for which a fee is charged may be prejudicial to other security holders as well as to the taxpayer." (1)

"These contrafts involve a minimum of cash investment by the controlling interest being mostly salaries. Anything received as fees over the cost of such management is profit to the holding company." (2)

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(1) FEDERAL TRADE COMMISSION, op. cit., p.844

(2) IBID, p.843





It is through these contracts that the holding companies have confined their business relations and business patronage to inside groups and have increased their power and influence over other businesses which receive their patronage.(1) The exclusion of independent contractors and independent engineering and construction companies has resulted in an absence of "arm's length" bargaining and a restraint of free and independent competition.

c. Write-ups.

In order to establish a base for excessive rates, the fixed capital account of the public utilities have sometimes been "loaded" with arbitrary or imaginary amounts.(2) Another practice has been the writing up of the fixed assets without regard to the cost thereof with the result of watering the stock or creating a fictitious surplus. There is disagreement among authorities as to the actual effect on rates of these practices where regulatory commissions are particularly strong.

d. Inadequate depreciation provision.

In order to meet the problem of adequate net income and pay interest and dividends on inflated capitalization, the management of some holding companies found it necessary

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(1) CONGRESSMAN EICHER, op. cit., p.52

(2) FEDERAL TRADE COMMISSION, op. cit., p.846





to resort to various devices for showing fictitious income.(1) One of these was a failure to include adequate depreciation provision on the fixed assets. The immediate consequence was an overstatement of net income. A possible result was the payment of dividends out of capital or original plant investment.

e. Intercompany sales.

Another detrimental development has been the engaging in transactions involving the purchase and sale of property or securities with controlled or subsidiary companies for the purpose of recording arbitrary valuation unjustified by market values. The holding company position in this field is adapted to the manipulation of rates and charges for intercompany sales in a way to increase or depress the revenues and profits of one company in relation to other companies in a holding company group. A Highly prosperous company might be obliged to purchase its energy at a higher, or sell at less, than a fair price to keep down its apparent profit, while an unprofitable company might receive excess benefit thereby.

Obviously an effect of public regulation designed to limit profits of individual companies is to tempt controlling holding company management to keep the apparent profits

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(1) FEDERAL TRADE COMMISSION, op. cit. pg.849





of the more successful companies just below the regulation point, transferring any excess profit to some other less favored or less regulated unit in the system. This has been true in the natural gas field where the consumer may pay higher rates because neither the transportation nor the production is a regulated public service.(1)

## 2. Investor

According to one well known utility operator, the public utility holding company and a public utility company have been synonymous, in the eyes of the investing public.(2) The results of such abuses as have been perpetrated by certain speculative holding companies have been and will be far worse for the investing public than for the consuming public, since the latter is protected from abuses by the regulatory control of operating companies.(3)

Investors have been affected by a)unsound or needless financial structures and practices and b) by the milking of operating companies. These arise from the possibilities of manipulation by insiders.

### a. Unsound or needless financial structures and practices.

Among the unsound or needless financial structures and practices which result in a disadvantage to the investor is the pyramided structure found in all the important holding

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(1) FEDERAL TRADE COMMISSION, op. cit. pg.853

(2) SAMUEL FERGUSON, PRES.HARTFORD ELECTRIC LIGHT CO.  
ELECTRICAL WORLD (Jan.21,1933)

(3) IBID





companies.(1) By the pyramiding of holdings through numerous intermediate holding companies and by issuing, at each level of the structure, different classes of stock with unequal voting rights, it has frequently been possible for relatively small groups to gain control by means of a disproportionately small investment and to manage solely in their own interest tremendous capital investments.(2) This feature represents the holding company at its worst, according to the Federal Trade Commission.(3)

Pyramiding is objectionable, not only because it makes for concentration of control, but it also aggravates the promotion of highly speculative stock--aptly called "high leverage stock" with features which make such issues unsuitable for investment purposes. This so-called "leverage" creates the appearance of earnings disproportionate to the actual earnings made by the underlying companies, and results in a high rate of return on common stock when operating companies are prosperous, but a low or no return when business of the operating companies shrink,(4) thus destroying the very stability of the securities which it is the function of the properly managed holding company to create.(5)

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(1) FEDERAL TRADE COMMISSION, op. cit., p.858

(2) BUSINESS ADVISORY COUNCIL FOR THE DEPARTMENT OF COMMERCE, loc. cit.

(3) FEDERAL TRADE COMMISSION, op. cit., p.860

(4) Ibid, p.858

(5) BUSINESS ADVISORY COUNCIL FOR THE DEPARTMENT OF COMMERCE, loc. cit.





Another unsound or needless financial device is that of capital inflation. Securities have been issued on the basis of fictitious and inflated asset values and in anticipation of excessive revenue and paper profits at the expense of underlying operating properties.

It has facilitated stock watering and similar forms of misfinancing and financial practices that tend to impose losses on thousands of small investors as well as to injure consumers by higher rates and poorer service.(1) None of the holding company groups examined by the Federal Trade Commission appears to have suitable capital structure from an investor's standpoint in the opinion of the Commission.  
(2)

Manipulation of the security market to deceive stockholders, bondholders or potential purchasers of its securities have been found. Speculation has been stimulated by putting funds into the call-loan market.

Huge transactions have been effected by mere entries on books of fictitious stock subscriptions without any transfer of money or credit.(3)

Holding companies in the utility field have been engaged in the "two master racket" whereby the same interest is both underwriter and trustee, both director and banker.

Unregulated public utility holding companies have encouraged unwieldly and uneconomic forms of consolidation,

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(1) BONBRIGHT AND MEANS, op. cit. pg.153

(2) FEDERAL TRADE COMMISSION, op. cit., p.859

(3) CONGRESSMAN RAYBURN, CONGRESSIONAL RECORD(June 27,1935)  
pg.10721





which violate the principles of maximum efficiency of operation,(1) and which tend to concentrate authority of operators instead of owners.

The public utility holding company has made for secrecy of corporate accounts and helped facilitate manipulation of the various constituent companies.(2) Despite protestation to the contrary no single holding company group can be said to have made public sufficient information to permit a clear understanding of all inter-company relations and transactions that have occurred within the group, or between members of the group and affiliated interests outside it. In a number of cases, such groups have done everything in their power,including court action, to delay or prevent disclosure or complete information in official inquiries. (3)

b. Milking of operating companies.

In order to support their own inflated capitalization and earn profits for themselves and holding companies higher in the series, the holding company have resorted to various devices in order to get the largest possible amount of revenue from the operating companies to the detriment of the investor in the operating company.

The service charge and numerous contracts and arrangements have been used to a great extent. In general, it can

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(1) BONBRIGHT AND MEANS, op. cit. pg.153

(2) IBID

(3) MOSHER AND CRAWFORD, op. cit. pg.353





be said that uncontrolled and often undisclosed charges for "services" assessed by remote holding companies and excessive fees paid to affiliates may, and sometimes do, defeat the purpose of rate regulation, assuming that purpose to be a minimum reasonable charge to the consumer.(1)

The holding company that makes ownership of the common stock equities of operating utility companies its principal line of investment is naturally desirous of obtaining the maximum of earnings from its investment.(2) Such earnings may be from dividends, service charges or fees for financial, construction engineering and management services.

Fees for operating supervision and management are charges to operations expenses which give the holding company a claim to the revenues prior even to the bond interest and dividends. These expenses are results of contracts between the right hand and the left hand of the same controlling corporate interest.(3)

By means of a tax or a general fiscal agent service, the holding company figured the tax for such subsidiary on the basis of operations for that subsidiary, then consolidated the return of the group, cancelling losses against profits. It collected the full amount of tax as computed from the subsidiary and realized a profit from this transaction since consolidated tax reports were permissible.

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(1) HANEY, op. cit., p.278

(2) FEDERAL TRADE COMMISSION, op. cit., p.842

(3) Ibid, p.843





However, this source of profit was eliminated by the passage of the 1934 Revenue Act, eliminating consolidated tax returns.

### 3. Public control.

The regulation of public utilities is hindered by the public utility holding company.(1) Managing holding companies have too often assumed the prerogative of managing properties at the same time in other relations have disclaimed responsibility on the ground that they were separate corporations.(2)

State laws have been circumvented by use of the voluntary trust, foreign ownership of stock, foreign incorporation and dummy holders of stock.(3)

The allocation of charges for service management, construction and other contracts among subsidiary public utility companies in different states have presented problems of regulation.(4)

The control of subsidiary public utility companies affect the accounting practice and rate, dividend and other policies so as to complicate and obstruct the state regulation of these subsidiary companies.

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(1) FEDERAL TRADE COMMISSION, op. cit., pg.871

(2) IBID, pg.,873

(3) IBID, pg.,879

(4) PUBLIC #333, pg.2





### Part III.

#### Governmental Relationships

##### I. Regulation

In our present economic organization, we rely mainly upon private enterprise to carry on the operations of industry. However, where private enterprise proves unable to fulfill its function or fails to function adequately, or where its activities endangers the general welfare, we resort to government intervention. This intervention may be prohibition or regulation of an industry.

Not only is the government concerned in this question of public and private ownership, but it has an interest in the performance of the corporation as a legal privilege since it is a party to the granting of the charter of incorporation. Moreover, the government has an interest in the holding company because the holding company is a phase of the trust movement and because it is now a part of the utility problem..

##### A. Necessity

Haney (1) states that there are two problems of business organization under which the holding company can come. One is the trust problem, the other the corporation problem. These problems are separate but interrelated. These problems arise out of a desire of the state to prevent unfair competition and carry out a rigid regulation of monopolies.

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(1) BUSINESS ORGANIZATION AND COMBINATION, op.cit., p.422





## I. The Trust Problem

The trust problem has to do with aggregation of capital tending towards monopoly and illegal ends. In exercising social and political control over monopolies, two alternative policies are open. We can maintain free competition by the elimination of monopoly conditions or we may permit monopolies but regulate their activities.

The first policy, that of maintaining competition and eliminating monopoly, has been the dominant one in dealing with the so-called trusts. This policy, as we have noted, has been applied to the industrial holding company but not the public utility holding company.

The second policy, that of regulation, has been followed in the control of railroad and other utilities.

## 2. The Corporation Problem

The holding company is definitely a part of the corporation problem, a larger problem which arises out of the privilege granted by the state creating an artificial person with limited liability and transferability of ownership.

Circumstances, supported by complex legal devices, like the holding company, have brought about the condition whereby management has been dissociated from ownership and responsibility. In theory and in the original simple corporate structure, the management of the corporation is elected by and responsible to the stockholders. With our modern





complex corporate structure, this theory seldom works out in practice.

Ownership of property in the form of corporate wealth is now widely held but the control of large corporations is concentrated in few hands. There are these two distinct groups, a widely dispersed group of investors and those in control of the corporation. Up to date, management has proceeded as if in ownership.(1)

The advantage of dissociating control from ownership is that it makes control stable and permanent.

However, this system has brought to the fore many problems. Berle and Means, in their "Modern Corporation and Private Property," say:

"The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state-economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation. Where its own interests are concerned, it even attempts to dominate the state."(2)

Another phase of the problem is due to the "liberality of laws" of certain states which give rise to many corporate evils. Such liberality includes "protection of excessive discretion by directors in the acquisition and sale of property; the recognition of contracts in which officers and

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- (1) JOSEPH P. KENNEDY, SATURDAY EVENING POST, January 16, 1937  
p.10  
(2) BERLE AND MEANS, MODERN CORPORATION AND PRIVATE PROPERTY,  
p.422





directors have private interests adverse to that of the corporation; the recognition of contracts with other corporations having the same officers, permission to issue stock of no nominal or par value; abrogation of the preemptive rights of stockholders to purchase new issues of securities; and legislative recognition of voting trusts." (1)

That there must be control over corporations is conceded. There is now some control over corporations, and the tendency is to make that control greater, not less.

### 3. The Utility Problem

It is in the field of local public utilities that the holding company has reached its highest stage of development.

Professor Bonbright declares that the controversy whether or not a better system than the holding companies might have been devised for the control of electric utilities is futile. "Fortunately or unfortunately", he says, "the holding company has become an integral part of the American public utility enterprise, and the practical issue is of its regulation rather than that of its destruction."

Many other writers believe that the holding company in this field can be a sound and useful institution if properly regulated.(2) Congress, on the other hand, has taken the position of elimination of most public utility holding companies.

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(1) FEDERAL TRADE COMMISSION, op. cit., No.73A, p.10

(2) PRENDERGAST, op. cit., p.98  
JONES & BIGHAM, op. cit., p.610





"Public control of utility corporations have two broad groups of objectives. The first, and most important, is designed to secure for the public as consumers the maximum extent, quality, quality and benefits of service consistent with a fair classification of nondiscriminatory rates that will afford a reasonable profit to the utility organization!"(1)

"The second group of objectives relates to taxes, taking property by eminent domain, property-holding rights, rights to conduct business, registration, issuance of securities, and other provisions of general state incorporation laws."(2)

In respect to the necessity for regulation of the public utility holding company as a public utility corporation, we find two points of view. According to one view, the holding company is neither in legal doctrine (3) nor in economic reality a public utility,(4) while the other view is that the existence and the management of the holding company are of decided public interest, and regulation of the operating company must necessarily be ineffective as long as the holding company remains free from control.(5)

As might be expected, the former view is vigorously urged by the utility interests. They claim that the only excuse for the regulation of utilities is to be found in the public

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(1) FEDERAL TRADE COMMISSION, op. cit., p.610

(2) IBID

(3) NASH, op. cit., p.422

(4) FEDERAL TRADE COMMISSION, op. cit., No.73 A. p.179

(5) BONBRIGHT AND MEANS, op. cit., p.149





interest in adequate service at reasonable rates. To be sure, other people, notably the investing public have interests which, on occasion, may require some degree of public protection from mismanagement and financial exploitation. This protection is not properly within the jurisdiction of the public service commissions or special statutes concerning public utilities. They claim that the investors in utility holding companies need no more special protection than investors in industrial and banking holding companies. The consumer only, has special need for protection against the unrestrained action of a public utility. The conclusion follows that unless the operations of a holding company can be shown to have a material effect on service or on rates of the public utility, that they are of no concern to a public service commission. Since a holding company by its very nature is not an operating company, and consequently does not charge any rates to the consuming public nor supply it with service, it has no effect on rates and service and should therefore not be regulated as a public utility.(1)

With regard to the legal viewpoint, even though a corporation controls the policies of a public utility and is known publicly to do so, nevertheless it is not a public utility in the legal sense and is therefore not subject to court action

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(1) BONBRIGHT AND MEANS, op. cit., p.149





and regulation as such. With few exceptions, the state commissions have declared and the courts have held that public utility holding companies are not public utilities as defined by the regulatory laws of the states.(1)

While legally it is not a public utility, nevertheless, it is claimed that since the public utility holding company through the ownership of voting stock names the directors and officers of the operating and subsidiary companies, it dictates the policies of the latter and therefore is an owner and operator of a public utility enterprise.(2) There are court decisions holding that corporate fiction may be disregarded where one company directs the affairs of another.(3) In certain situations where the parent holding company and its subsidiaries are to all intents and purposes run as one corporation, the courts will disregard the separate corporate entities. The test of the courts appears to be whether the ownership of stock of the holding company is resorted to for making the subsidiary a mere agent or instrumentality and of so co-mingling the affairs as to make the two companies virtually one.(4)

Unless this theory of the "disregard of corporate entity" is availed of, there is serious question whether a holding company, even if defined as a public utility by legislative declaration, can be subjected to direct regulation under

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(1) NASH, loc. cit.

(2) FEDERAL TRADE COMMISSION, loc. cit.

(3) PRENDERGAST, op. cit., p.97

(4) CLAY, op. cit., p.249



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existing conditions, which necessitate a determination that the holding company is engaged in a "public" business.(1)

In a study of the legal status of the utility holding companies and the basis for Federal legislation under the commerce clause by Jay L. Jackson,(2) it is shown that the public utility holding company of itself, apart from the control it exercises over the operating companies, so closely approximates an undertaking which may be said to be "affected with a public interest" that it may be held to be within this special category.

#### 4. Public Interest

With reference to the second view, that the public utility holding company's existence and management is of decided public interest, we find that the public, according to Bonbright and Means, (3) is increasing in its demand to bring the holding company under effective supervision.

Since it is a general principle of law that requires legislation to be in the public interest,(4) it is necessary to set forth the reasons why it is of decided public interest to regulate the holding company in this field.

##### a. Magnitude

In the first place, justification for the regulation of holding companies is because of their magnitude.(5) It is claimed that the holding companies dominate the utility

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(1) CLAY, op. cit., p.249

(2) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.218

(3) THE HOLDING COMPANY, op. cit., p.200

(4) DOZIER DE VANE, HEARINGS ON H. R. 5423, op. cit.,p.543

(5) PRENDERGAST, op. cit., p.66





industry with 12 billions (1) invested by 4 to 5 million people.(2)

While size is interesting, mere size in business and industrial concerns is no longer a terror to the public. The tendency towards combination into large groups may be defensible and perhaps inevitable from the technical point of view but it has been a constance source of irritation in the relations between the consumer and the public utilities.(3)

Great size, however, has its disadvantages arising from permitting a group of capitalists to exercise a large degree of arbitrary power over large areas and large numbers of people. The financial and political influence which such groups may be able to exercise is unhealthy, especially in regions lacking other economic organizations of equal strength.(4)

#### b. Concentration of Control

In the second place, they must be regulated because of their concentration of control. There is a feeling that this control gives economic power to a privileged few to control the investment, the business, and the livelihood of the many.(5) Not only is this control centered in the utility industry by means of voting trusts, interlocking directorates and officers, management contracts and the control of proxies,(6) but it has spread to other industries to whom the utilities distribute its enormous business and to the newspapers it allots its

(1) NEW YORK TIMES, (SEPT.27,1936)p.10E. ARTICLE BY HAROLD E.HINTON

(2) REPRESENTATIVE EICHER, H.R.1318, op. cit., p.48

(3) NEW YORK TIMES, loc. cit.

(4) FEDERAL TRADE COMMISSION, op. cit., No.72A.,p.880

(5) CONGRESSMAN, EICHER, op. cit.,p.47

(6) NATIONAL POWER POLICY COMMITTEE, op. cit.





advertisements.(1)

Concentration of control is speeded up by the system of interlocking directorates; by the retention by small, inside groups of the voting stocks of holding companies and by the pyramiding of holding companies one upon the other. According to Senator Wheeler, (2) "the present development of electric utility science and mechanics requires no such concentration of control in an essentially local industry.....A sound distribution of economic power, economic responsibility and economic opportunity between localities and between individuals absolutely requires a breaking down of that concentration."

Says the Federal Trade Commission: "The holding company in the utility field has been the chief device by which the control and ownership of operating companies has been rapidly concentrated in fewer hands with every prospect that the process will continue on to nation-wide monopoly unless there be governmental regulation." (3)

### c. Investor

According to the "liberal" view, they must also be regulated in the public interest because of the investor. The securities of the public utility holding companies are sold to a large number of investors. These investments, both by private individuals and fiduciaries should, in the greatest

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(1) REPRESENTATIVE EICHER, op. cit., p.49

(2) CONGRESSIONAL RECORD, (March 28,1935) p.4774

(3) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.63





public interest, be as safe, staple and non-speculative as is practical to make such investments.

According to Prendergast, (1) there is nothing essentially wrong with the holding company plan as far as the investor's are concerned. The task is to make all utility holding companies sound, and free from all charges of overcapitalization and unsound security sales.(2)

However, investments in public utility holding companies are so widely diffused that millions of American citizens would be affected by any steps taken toward regulation.

#### d. Consumer

In the fourth place, the public utility holding company must be regulated because of the consumer.

Professor Bonbright is one of the many who believes that the activities of the holding company in the public utility field are of interest to the rate payer. He does not agree with the contention that rates are not affected by the capitalization and management of the holding companies, by the prices they pay for controlling interests in the subsidiaries, and by contracts for management services they make with subsidiaries. He holds that rates are affected by these items. He says that the assumption that rates are fixed by an automatic process based on physical valuation are

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(1) PUBLIC UTILITIES AND THE PEOPLE, op. cit., p.93

(2) IBID, p.74





not supported by facts in most cases. Most rate reductions, he claims, have been the result of negotiation or have been voluntary. This being true, he contends, that the financial needs and charges of the dominating holding companies do exert unfavorable influence on rates and also on extension of service facilities. (1)

According to Professor Haney, (2) from the public point of view, power without responsibility is the great objection to holding company organization.

In the first place we have seen that the financial liability of the members of a holding company may be only a fraction of their financial power.

In the second place, they are under no adequate responsibility for their economic and social power.

## B. Survey of Laws

Whatever alleged evils have accompanied the growth of the holding company in the public utility industry, the fact is obvious that they were not prevented by that body of State laws which the utility industry has defended as efficient regulations, according to the Federal Trade Commission. (3)

### 1. State

#### a. Extent

In the reports of the Federal Trade Commission (4), it is noted that while twenty-eight states and 3 territorial possessions have established the right of one corporation to

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(1) BONBRIGHT AND MEANS, op. cit., p.149

(2) BUSINESS ORGANIZATION AND COMBINATION, p.277

(3) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.1

(4) IBID, No.69A., p.2



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(1) BOWBRIGHT AND KEANS, op. cit., p. 143  
(2) BUSINESS ORGANIZATION AND COMBINATION, p. 277  
(3) FEDERAL TRADE COMMISSION, op. cit., No. 73A, p. 1  
(4) IBID., No. 69A, p. 2

to hold stock in another corporation, in 21 of these 31 jurisdictions, no control whatsoever is provided over the holding companies organized pursuant to the statutory privilege.(1)

Holding companies have not been otherwise regulated except as to the certification of their issues by so-called "blue-sky law authorities". But this supervision has not been of the searching nature which has characterized the supervision by public service commissions.(2)

The regulation of the utility industry by the states has been left chiefly to state commissions. The basis of this state regulation is the police power as interpreted in the light of constitutional amendments.(3) At present, every state has public utilities or public service commissions with the exception of Delaware.(4)

Regulation of utilities was at first left largely to local bodies but since the local utilities gradually outgrew their city boundaries and demands were made that the state supervise their activities. At the outset of which state regulation dates around 1907, the utilities were opposed to it, and challenged it constitutionally. Failing in that challenge, they became more and more reconciled to state regulation as the courts gradually built into it a body of laws which protected the interest of the utilities.

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(1) FEDERAL TRADE COMMISSION, No.71A.,p.2

(2) PRENDERGAST, loc. cit.

(3) MUNN vs. ILLINOIS, op. cit.

(4) LAIDLER, op. cit., p.415





b. Scope

State regulation is not a coherent, consistent body of laws and administrative requirements. There is a wide difference in the extent and effectiveness of the regulatory policies of the various states.(1) Eight states have no regulation of electric and gas companies, sixteen have no control over electric or gas company security issues, twenty-three have no control of capitalization of assets of operating companies while in some states having regulatory commissions, these commissions are inadequately financed or lack adequacy of resources in money and experienced and capable personnel when opposing the more important holding companies.(2)

There are two ways by which a regulating commission may be given control over a company which holds the stocks of public utilities subject to its jurisdiction.(3) The first way is to recognize the holding company itself as a public utility while the second method is to secure indirect control by subjecting the operating company to various restrictions in its relation to the holding company.

It was suggested by the National Association of Railroad and Public Utilities Commissioners, that holding companies

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(1) FEDERAL TRADE COMMISSION, op. cit., No.73A.,p.1

(2) IBID, No.72A.,p.873

(3) BONBRIGHT AND MEANS, op. cit., p.201







should be defined as public utilities. Where states have assumed some jurisdiction, it was found to be unsatisfactory.

It is claimed that were they able to classify the holding companies as utilities, the state commissions would be unable to cope with the situation since they have difficulty in regulating the operating companies.

Up to the present time, at least, the only really significant influence which public service commissions have had over the holding company has been exercised by the power to regulate the action of the subsidiary operating company.(1) This takes the form of regulation of security issues (2) and by regulation of service contracts.

The present law in Massachusetts, (3) which provides that no foreign corporation owning a majority of stock of certain utilities can issue stock based on the property of the domestic utility, unless such issue has been specifically authorized in Massachusetts is typical of a method to control the holding company through its operating company. However, this provision of the law has been successfully evaded through the use of the so-called Massachusetts Trust.(4)

The attempt of the Massachusetts legislature to thus control the holding company is a rare exception to the general practice.(5) The more usual method is to require that a holding company first secure the approval of the Public Service

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(1) BONBRIGHT AND MEANS, p.206

(2) NASH, op. cit., p.423

(3) G.L.C. MASSACHUSETTS, CH.181 sec. 10. see also General Laws of the Commonwealth of Massachusetts, Ch.156,sec.5 for domestic corporations.

(4) NASH, loc. cit.

(5) BONBRIGHT AND MEANS, op. cit.,p.208







Commission before it can acquire a limited percentage, usually ten per cent, of the stock of an operating utility. In general the protection which this provision has given the public is questionable (1) since corporations by organizing ten dummy corporations could and did purchase stock and so evade the law.(2)

Efforts to regulate holding company management sales and service contracts have had to encounter almost complete lack of jurisdiction over the dominating party in such contracts. This regulation has been limited to the regulation which commissions have had over the operating companies, except in a number of States in which legislation has recently been enacted for the purpose of giving State commissions some control over the parent or affiliated company.

The officials of the holding company see no necessity for regulation of contracts since State commissions may refuse to recognize as legitimate operating expenses the fees paid to holding companies to the extent that they are unreasonable.(3) Reasonableness of fees is a matter of opinion, however.

### c. Adequacy

There are a number of almost inherent abuses which can not be reached by direct regulation of the operating companies.

There also are limitations to regulation.(4) A commission under the "guise of regulation" cannot manage the

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(1) SENATOR DICKINSON, CONGRESSIONAL RECORD, p.9090

(2) HEARINGS ON H. R. 5423, p.236

(3) JONES AND BIGHAM, op. cit., p.604

(4) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.167





affairs of an operating company, nor can it set aside arbitrarily an transaction or contract with an outside agency (which may be a holding company in the eyes of the law) nor can such company be deprived of its constitutional rights.

State commissions, as we have seen, have very limited powers with respect to regulation of holding companies. Those who have adopted a thorough-going policy or system of utility regulation have encountered insuperable difficulties growing out of constitutional limitations, economic developments, and the attitudes of both the industry and the law courts.(1)

Under our constitutional form of government each of the States has the power of issuing corporate charters and determining the conditions under which such corporations may do business. Our constitutional system precludes the exercise of jurisdiction by any one State within the territory of any other State.

The Federal government has jurisdiction over commerce among the several states and with foreign nations. Congress has the authority to regulate not only this interstate and foreign commerce but those transactions which substantially affect that commerce. The courts have even held that commerce which is purely intrastate in character is subject to regulation if it affects and constitutes an obstacle to the regulation of interstate commerce. The several states, on

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(1) FEDERAL TRADE COMMISSION, p.28 No.73A.



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the other hand, have power to control intrastate commerce. Conflicts of jurisdiction can easily occur in which regulatory authority will be asserted by both the State and Federal governments. State regulation can easily be avoided by a utility through carrying its operations across a State line, even only to a minor extent as in the case of the Attleboro Steam and Electric Company. (P. U. R. Commission of R. I. vs Attleboro Steam and Electric Co.)

The development of holding companies which transcends the geographical limits of the individual States in which its operating units are located, necessarily transcends the power of those States to effectively regulate them.(1) Large capital must be organized to take advantage of long-distance transmission with the result that ownership and control of the companies leave the state seeking incorporation under more liberal corporation laws.(2)

Just as local authorities have failed in their task of regulation because the industry operated beyond their borders, so the states are bound to fail in the same condition where the operations of the utilities extend beyond their jurisdiction.

State regulation, also, was effectively held up by the plea of interstate commerce resulting in a loss of expense and of time and in humiliation to the State.(3) The disposition of the utilities to seek protection of the Federal courts against what they considered unwarranted exercise of State regulation

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(1) FEDERAL TRADE COMMISSION, op. cit., No.72A.p.32

(2) MOSHER AND CRAWFORD, op. cit., p.367

(3) FEDERAL TRADE COMMISSION, op. cit., No.73A.p.79



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(1) FEDERAL TRADE COMMISSION, op. cit., No. 72A.p.32

(2) MOSHER AND CRAWFORD, op. cit., p.387

(3) FEDERAL TRADE COMMISSION, op. cit., No. 72A.p.79

was stopped by prohibiting the utilities to resort to the Federal courts in rate cases except where they involve federal commerce.

Then too, the public buys holding company securities believing that they are purchasing public utility securities which are subject to state commissions. When the companies collapse or the securities fall in value, the entire system of regulation is looked upon by the public as responsible when in fact it had no control.

State public service commission and commissioners have been keenly aware of the holding company problem. Being generally fearful of the encroachment of the Federal Government on states' rights, they have, as a general rule, not looked with favor on proposals of Federal regulation of holding companies. On the contrary, they have sought legislation giving them greater power. For the most part, such legislation has not been enacted.(1)

Besides the states omitting or being unable to exercise the function of regulating the holding companies, we find that they have created or promoted certain evils by pursuing a policy of liberality of laws regarding corporate practices.(2)

The unrestricted ownership of stock by one corporation in

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(1) PRENDERGAST, op. cit., p.81

(2) FEDERAL TRADE COMMISSION, op. cit., No.73A. p.10





another which is possible now under the state laws has had the effect of creating a corporate structure so vast and so complex as to pass beyond state control.(1) It is interesting to note that Delaware, the state which is popular with holding companies is about the most liberal in its laws. It does not even have a public service commission,(2)

Professor Haney says of the state regulation of public utility holding company:

"Its amphibiousness makes state control futile; for while it operates under a state certificate or incorporation and its units are state corporations, its business is interstate and beyond control and by procuring incorporation from a lax state and forming subsidiaries in hostile states, the regulations concerning foreign corporations may be evaded in part." (3)

## 2. Interstate Compacts

Interstate compacts have been suggested as a method of meeting the holding company problem. Such a device is impliedly authorized by the Constitution and has been used to settle disputes between states and provide coordinated action by several states. A recent example is the Colorado River compact, which is an agreement between affected states for an apportionment of river waters in connection with the building of Boulder Dam by the Government. The compact did not concern the regulation of the generation and transmission of electric energy at the dam.

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(1) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.10

(2) LAIDLER, op. cit., p.415

(3) BUSINESS ORGANIZATION AND COMBINATION, p.277





The requirement that Congress consent to such a compact insures a degree of supervision by the National government while the actual methods of control are determined by the several states who are parties to the negotiation. Conferences looking toward such a compact to regulate the light and power industry common to the states of New York, New Jersey and Pennsylvania, were held in 1925, but no agreement was reached. Congress has given its consent to 60 compacts and none has yet been invalidated by the United States Supreme Court. (1)

The advantages of legislating by means of interstate compacts is found in the fact that there is no danger of imposing on states regulations determined by other states having no direct concern nor intimate knowledge of conditions. States need not necessarily be contiguous to enter into compacts.

The possibilities of this device as a method of providing regional regulation have been outlined by Frankfurter and Landis.(2) However this method is not feasible where consolidations have been indiscriminate and only occasionally accompanied by physical interconnections. None of the larger systems whose far-flung activities have created the necessity for additional regulation is limited to a single region.

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(1) CHRISTIAN SCIENCE MONITOR, Nov. 21, 1936

(2) I HAVE FOUND MANY REFERENCES TO BUT HAVE NOT EXAMINED FRANKFURTER AND LANDIS, THE COMPACT CLAUSE OF THE CONSTITUTION, 34 YALE LAW JOURNAL 685, 1925.





### 3. Federal

Enthusiasts for greater intervention by the government in the field of public utility regulation are inclined to ignore the fact that our Federal system of laws is one of delegated powers. Under the Constitution all powers not delegated to the National government are expressly reserved to the States.(1)

#### a. Constitutional Aspects

According to the traditional interpretations of the distribution of powers between the State and Federal Governments, mere inadequacy or ineffectiveness of State control does not clothe the Federal government with authority to act. Such authority flows from powers expressly granted in the Federal Constitution.

Since one effective way of meeting the holding company problems is to have state regulation supplemented by Federal regulation,(2) it is pertinent to inquire into the legal aspects of Federal regulation.

There are three general powers conferred upon the Federal Government by the constitution under which may be classified the bulk of Federal legislation designed to regulate during normal times, business relations and economic conditions.(3) They are the powers to regulate interstate and foreign commerce, the power to impose taxes, and the power to operate the postal system as a monopoly.

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(1) CLAY, op. cit., p.140

(2) PRENDERGAST, op. cit., p.96

(3) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.34





## 1. Interstate Commerce

The Federal power to regulate commerce was the unifying factor which has made possible the creation of the Federal government and a complete freedom of trade among the states. It is the power called upon most extensively in framing regulatory statutes.

Congress may prescribe the conditions under which corporations can do business in interstate commerce and can require the dissolution or divestment of property where reasonably necessary to bring about desired conditions in this field.(1)

This interstate business can be applied to the holding company in two ways;- either through the transportation of energy from one state to another or through the sale of securities in interstate commerce.

It has been contended that holding companies are not engaged in interstate commerce and therefore are not subject to regulation by the Federal government.(2) On the other hand, the Federal Trade Commission cites fifty-nine court cases since 1891 in which gas and electric utility companies have challenged and delayed, frustrated or defeated state regulation by setting up the defense of being engaged in interstate commerce.

It has been held that ownership of stock of a corporation in another state and the use of the mails for transactions of business do not constitute interstate commerce. There is also

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(1) MEMORANDUM IN SUPPORT OF CONSTITUTIONALITY OF HOLDING COMPANY BILL, loc. cit.

(2) PRENDERGAST, op. cit., p.97





some doubt as to whether the sale of securities from one state to another is interstate commerce.(1) However Congress has already asserted its jurisdiction over security distribution in passing the Securities Act of 1933 and the Securities Exchange Commission Act of 1934.

## 2. Taxes

The Federal power to levy taxes is a broad power. The express limitation to this power is in the constitution while the implied limitations are those implied by the dual nature of the American system of government and those of the Fifth Amendment.

Since taxes may be imposed as a method of policy as well as a regulatory measure,(2) the Federal Trade Commission recommended six tax proposals to regulate holding companies.(3)

Taxes may take the form of privilege, property or income taxes and may be aimed either at the companies themselves or the purchaser of their securities. Constitutional problems encountered are questions of directness, uniformity and classifications.(4)

The recent elimination of consolidated tax returns which have encouraged the development of corporate superstructure(5) will have an effect on the holding company. The simplicity of corporate structure due to tax burdens has become a well-defined tendency. Wall Street traces the vogue to the

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(1) NASH, loc. cit.

(2) FEDERAL TRADE COMMISSION, op. cit., No. 73A. p. 191

(3) IBID, p. 68

(4) LEGAL STUDY ON TAXATION AS A MEANS OF REGULATING HOLDING COMPANIES. HOUSE REPORT, NO. 827, op. cit., p. 165

(5) IBID, P. VII.





amending of the income tax laws in 1934 which abolished consolidated returns and required separate statements for each unit in the corporate group, except railroads. Pressure for simplification was increased by making intercorporate dividends partly taxable and by the lowering of exemptions on dividends received by one unit from another under the Revenue Act of 1936. Corporations were freed from the capital gains tax in shifting properties from one unit to another as was suggested to help the disintegration of the objectionable holding company system by encouragement through tax exempting the issuance of exchange of securities incident to an equitable distribution of equities among the security holders of existing corporations.(1)

### 3. Postal System

Congress may restrict the use of the mails in the public interests. This is a powerful weapon and is limited only by the general limitations and prohibitions of the Constitution. It must not deny due process of law, abridge freedom of speech or make unreasonable searches and seizures.

Congress obtains its authority to regulate the postal system under its power to establish post offices and post roads. The interest of the government is both proprietary and regulatory, thus the power of Congress is even more comprehensive than that over interstate commerce.(2)

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(1) REPORT OF COMMITTEE ON THE PUBLIC UTILITY HOLDING COMPANY BILL OF THE BUSINESS ADVISORY COUNCIL FOR THE DEPARTMENT OF COMMERCE, APRIL 30, 1935, also, WALTER M.W. SPLAWN, SPECIAL COUNSEL OF HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, IN HOUSE REPORT NO.827, Part 2., P.VIII.

(2) MEMORANDUM IN SUPPORT OF HOLDING COMPANY BILL, loc. cit.





## b. Federal Incorporation

One method that the federal government through Congress might employ to regulate holding companies in interstate commerce is by means of federal incorporation.(1)

In the administration of Theodore Roosevelt, bills were introduced into Congress to provide for federal incorporation or licensing of corporations in interstate commerce.

At first, the objective stressed was the breaking up or the regulation of monopoly and monopolistic tendencies in business. Then leaders in industry became interested in the advantage of uniformity and relief from conflicting jurisdictions.

President Taft in his message of 1910 recommended a federal incorporation law and a bill known as the Taft-Wickersham Act was drawn.(2) President Wilson in his message of 1919 and 1920, revived the recommendation of Federal licensing.

The Federal Trade Commission suggested something of the sort for the controlling of the Public Utility Holding Companies.(3) The National Recovery Administration proposed it as a means of enforcing labor standards, collective bargaining and unfair competition. The China Trade Act of 1922 included a federal incorporation plan.

The President of the New York Stock Exchange has publicly gone on record in favor of a Federal law governing the incorporation of companies.(4) The American Federation of Labor has

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(1) BRIEF IN SUPPORT OF CONSTITUTIONALITY OF PUBLIC HOLDING COMPANY,BILL, op. cit., p.8714

(2) FEDERAL TRADE COMMISSION, op. cit., No.73A., p.43

(3) IBID, COMPILATIONS OF PROPOSALS AND VIEWS FOR AND AGAINST FEDERAL INCORPORATION.OR LICENSING OF CORPORATIONS,op.cit.No.69A

(4) STOCK EXCHANGE PRACTICE HEARINGS BEFORE COMMITTEE ON BANKING AND CURRECNY, Pt.15, p.6637





supported the Federal Licensing of corporations in interstate commerce for the third time in recent conventions.(1)

The Constitution of the United States does not give Congress direct authority to create corporations, but it may create corporations for the purpose of carrying out these powers expressly granted to it.(2) There are three types of legislation:1) Voluntary federal incorporation, 2) Compulsory federal incorporation, 3) Federal licensing of state-chartered corporations engaged in interstate commerce.

Objections to any or all have been raised in the gravest terms and by lawyers and statesmen whose names rank with those of the proponents. Of first magnitude is the fear expressed concerning concentration of power in the Federal Government.

Other questions have been raised. Could the Federal government, granting its power over interstate commerce, issue a charter for corporations which have been held to be local undertakings subject to state jurisdictions? If the federal chartering power should surmount the many difficulties, would it not be taking away the authority of the states to tax the franchise and the property of the corporations and so deprive the states of a large and even vital share of their revenue? (3)

Among the conditions which Congress might impose in the granting of the privilege of engaging in interstate commerce, as a corporation is a complete prohibition against ownership of

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(1) CHRISTIAN SCIENCE MONITOR, (November 23, 1936) Volume XXVIII No.36, P.1.

(2) ACCOUNTANT'S HANDBOOK, op. cit., p.20

(3) FEDERAL TRADE COMMISSION, op. cit., No.73A.,p.45





stock in another corporation.(1) In the case of corporations organized in the District of Columbia, which are created by Federal authority, Congress has adhered to the common law rule where stock ownership is unknown.(2)

c. Extent

The Federal Power Commission Act of 1920 creates a commission empowered to license private organizations and municipalities to develop, transmit and utilize power from government property, where the Federal government has the natural rights of a proprietor or sovereign. It was enacted as a conservative measure rather than one complementary to state regulation.

In 1931, the Federal Power Commission voted to study the subject of holding company control of its licenses. The report was released in 1932 and is summarized as follows with regard to holding companies:-

1. Public control of holding companies in the power field is absolutely essential in the public interest and should include supervision of contracts, regulation of the issuance of securities and regulation uniformity and publicity of accounts.

2. Data discloses dominance of holding companies in projects licensed under the Federal Power Act and the inadequacy of books of the licensees themselves for complete determination of costs, reserves etc. A similar situation applies to the

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(1) MEMORANDUM IN SUPPORT OF CONSTITUTIONALITY OF HOLDING COMPANY BILL, loc. cit.







Commissions jurisdiction over companies engaged in interstate transmission and companies not regulated by state commissions where controlled by holding companies.

3. Of the major licensed projects, 1103 on June 30, 1932, 48 were controlled by 10 holding companies whose system served a population of more than 42 million. A community of interest between these ten groups was shown by the fact that 19 directors were directors or officers in more than one group.(1)

2. Securities Act of 1933 and the Securities and Exchange Commission Act of 1934

An indirect and limited form of Federal regulations has resulted from the incidental inclusion of utilities under the Securities Act of 1933 and the Securities and Exchange Commission Act of 1934. They set up certain methods of regulating interstate commerce in corporate securities for the purpose of protecting the investor against fraudulent misrepresentation in his purchase of securities and against manipulation of the security market to his detriment.

While it seeks to protect the investor from fraud and deceit, it does not protect the rate payer nor substitute Commission judgement for investor's and enterprisers' judgement regarding underlying values of property, investment advantage and risks of capital investments.(2)

Fraud is illegal, but not all illegality is fraud. The securities act does not provide standards by which legality of operations may be determined. The illegality of proposed corporate projects and their effects on investments, competition

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(1) HOLDING COMPANY CONTROL OF LICENSES OF FEDERAL POWER COMMISSION, P. VIII.

(2) FEDERAL TRADE COMMISSION, op. cit., No.73A.,p.30





and interstate commerce will be seldom, if ever, be made apparent on the face of the registration statement, thus making for little, if any, effect on the present unrestrained ability of the holding company to operate to the detriment of the investor.(1)

### 3. Public Utility Act of 1935

The Public Utility Holding Company Act of 1935 provides for the regulation of holding companies in the electricity and gas business by the Securities and Exchange Commission, which may ultimately order the dissolution of needlessly complex set-ups. By this act, public utility holding companies beyond the second degree will be illegal after January 1, 1938, except closely integrated groups operating in one state or adjoining states (New England Power Association, for example) or extending into Canada or Mexico, may continue a three-layer structure, if the Securities Exchange Commission finds that such companies operate more efficiently under that set-up, and if the system does not become unwieldy for effective local control.

The Act further provides that interstate operations of power companies shall be put under Federal regulation at once. Such companies must register with the Federal Power Commission, created by the Act, on October first, 1935 and those not so registering will be barred from the mails. The Commission is given authority to supervise rates, accounting and property acquisitions.

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(1) FEDERAL TRADE COMMISSION, op. cit., No. 73A., p. 214





The Securities Exchange Commission is charged with the responsibility of eliminating holding units which are outlawed by this Act and of supervising securities issues by holding companies and their subsidiaries. To this end, electric and gas companies are required to disclose their corporate structure fully and fairly. Dividend, proxies, inter-company loans, contracts, utility assets and other interests are to be submitted to the commission.

The Wheeler-Rayburn Act has an important bearing on interstate utilities, since the size and geographical extent of systems under holding companies are subject to it.

In its effort to break up large "economic empires", the government has "sentenced to death" utility holding companies with scattered holdings. The final act is not the severe absolute death sentence originally put forward by the President.

Much is left to the discretion of the Securities Exchange Commission. "Five men will decide to what extent the public interest requires the dismantling of corporate structures built with millions of dollars invested by millions of people...The holding company could be obliterated and still the electric power business would go on...It is a major move in the campaign for federal control of business" comments the United States Chamber of Commerce.(1)

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(1) NATIONS BUSINESS(October 1935) p.21





The favorite argument used against this legislation was to the effect that the proposed bill would destroy values and thereby ruin "widows and orphans".(1) Here is what happened, according to Mr. Kennedy (2). On December 31,1934, before the bill was introduced, the average of the sixteen largest utility holding company stocks was 8.16. On February 6,1935, when the bill was introduced, the index was 7.13. On March 12,1935, when the President sent his message on the bill to Congress, the average had fallen to 5.70, but on August 26,1935, when the bill became law, this average had risen to 12.22 and it now stands at about 20. For the same periods, the average of the nine largest operating utility companies' stocks was 44.86, 45.49, 46.35, 88.54(3).

On November 7,1936, Federal Judge William C. Coleman held the act unconstitutional, accusing Congress of flagrant violation of its powers under the Constitution.(4) The opinion found three separate directions in which Congress had exceeded its authority. First, the "commerce clause" of the Constitution was violated in that application of the act could not be restricted to companies operating only in interstate commerce. Secondly, there was an invalid use of the postal power in denying the use of the mails to companies not co-operating under the act. Thirdly, it was held that Congress violated the re -

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(1) ARTICLE BY JOSEPH E. KENNEDY, IN THE NEW YORK TIMES MAGAZINE, (September 6,1936)

(2) IBID

(3) IBID

(4) BOSTON POST, FRIDAY, NOVEMBER 8,1935





quirements of the "due process of law" under the fifth constitutional amendment in that many provisions of the act are arbitrary.

Regardless of whether the supreme court sustains the much debated Public Utility Holding Company Act, the United States is going to have federal regulation of public utilities. The issue is what kind of regulation there shall be of interstate transactions in gas and electricity, and gas and electric company finances.

The public service committee of the Investment Bankers Association said in its annual report in October, 1935, "Whatever the final decision may be, the Public Utility Act marks not an end, but a beginning....of federal regulation within proper legal limits".(1) Wendell L. Wilkie, President of the Commonwealth & Southern Corporation, appeared before the Senate Committee on Interstate Commerce in April, 1935 and outlined a long list of regulatory recommendations which he proposed in preference to the measure subsequently passed by Congress.

The arrival of this federal regulation is significant in many ways. It has a social significance in the protection of the pocket-book of the consumer and the future investor. What it may do to the past investor who owns holding company stock

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(1) NEWS ITEM, CHRISTIAN SCIENCE MONITOR, January 22, 1936





is a matter of divided opinions. It has governmental significance, raising the question whether its greater effect will be to protect the states in their contests with the companies or to invade the states and break down their systems of regulation. It has economic significance, for especially if the "death sentence" section against utility holding companies should be upheld, there are those who anticipate that the next step of the Roosevelt Administration would be to attempt similarly to break up large industrial holding companies.

## II. Competition

The holding company problem and the public ownership issue are related. The contest today over the future disposition of the electric utility industry is between regulation chiefly by state commissions with supplementary regulation by Federal bodies and public ownership.(1) Since public ownership is a problem in itself, I will touch briefly its effect on the holding company in the utility field.

### A. Local

Public ownership of utility plants offers competition to the holding company through the local utility plants. The value of holding company obligations are based on the earning value of the operating companies and public confidence.

In August, 1936, the Federal Power Commission reported

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(1) PRENDERGAST, op. cit., p.313





that publicly owned utility plants are increasing and that the number of privately owned units is decreasing by approximately the same degree. The trend toward public ownership, small though it may be, has alarmed and continues to alarm investors in and managers of commercial utility plants(1)

The Federal government through the Public Works Administration can and does give government money to municipalities to build competitive plants, thus affecting the holding company indirectly by duplicating existing private power facilities.(2)

## B. Sectional and National

### 1. Tennessee Valley Authority

In an attempt to regulate utilities by competition, there has been written into the power policy of the Tennessee Valley Authority the idea of a "yardstick" by which to measure the fairness of public utility rates and financial practices.(3)

The T. V. A. is a federal corporation created by an act of Congress on May 18, 1933 (4) and bolstered by amendments in 1935 with all the powers of the holding company. The act definitely puts the government into the business of rendering electric service. The Authority is required to acquire

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(1) NEW YORK TIMES, loc. cit.

(2) NATION'S BUSINESS, (July 1936) p.23

(3) BUSINESS AND GOVERNMENT IN THE TENNESSEE VALLEY, David E. Lilienthal. He is also author of several well-known authoritative articles on the holding company. See Lilienthal. The Regulation of Public Utility Holding Company, 29 Columbia Law Review(1929) and Recent Developments in the Law of Public Utility Holding Companies 31 Columbia Law Review, (1931)

(4) 48 STAT. 58





a market and set up an area in which to conduct its operation of business.

Under the terms of the act creating the authority, preference in the sale of surplus power is to be given to "States, counties, municipalities and co-operative organizations of citizens or farmers not organized or doing business for profit". This clause has led directly to P. W. A. grants for municipal plants in the valley region.(1)

It is claimed that the T. V. A. will remove the potential dangers and disadvantages of public ownership, a thought that the utilities and the holding companies in this field are fighting.

The legal objection to the T. V. A. by the utilities, boils down solely to the question of whether its primary purpose is the sale of electricity rather than navigation and whether this is an implied constitutional power of the United States.(2)

The economic objection to T. V. A. by the utilities boils down almost completely to the question of whether the power is fairly priced or whether it is subsidized by Federal taxpayers.(3)

There appears to be no doubt on anybody's part that the T. V. A. can take business away from the private companies as

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(1) NEW YORK TIMES, February 23, 1936  
 (2) ,CHRISTIAN SCIENCE MONITOR, August 28, 1936, p.13  
 (3) IBID





fast as it wants to on a purely competitive rate basis.(1)

In the opinion of Commissioner Seavey,(2) the creation of the T. V. A. has made it easier for the public service commission of the States to adjust rates to afford the public large savings in the last two years.(3) Wendell L. Wilkie, President of the Commonwealth and Southern Company, claims the T. V. A. competition has had the effect of retarding the private electrical enterprise in the district as shown by a decrease in the 1937 operating budget and an inability to refund securities.(4)

## 2. Affiliate

An agency affiliated with the T. V. A. is the Electric Home and Farm Authority created by an executive order December 19, 1933, incorporated in Delaware January 17, 1934 by the directors of the T. V. A. and re-incorporated in the District of Columbia to do a "chattel-mortgage-loan-business". Its purpose was primarily to finance the installment buying, and to buy, sell and deal in electrical appliances.(5) Its life is seven years.

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- (1) CHRISTIAN SCIENCE MONITOR, August 28, 1936, p.13
  - (2) CLYDE E. SEAVEY of the SECURITIES EXCHANGE COMMISSION, Address before Public Utility Section of the American Bar Association, Boston, August 25, 1936 as reported in Boston Post, August 26, 1936
  - (3) NEW YORK TIMES (January 3, 1937) p.F.1.
  - (4) IBID
  - (5) CONGRESSIONAL RECORD, June 27, 1935, p/10738





The Tennessee Valley Associated Co-operatives, Inc., was incorporated in the State of Tennessee by the three directors of the T. V. A. for the purpose of promoting and financing co-operative enterprise and industry in the Tennessee Valley region. It has perpetual existence and its capital, \$300,000, was a present from the F. E. R. A.

### 3. Rural Electrification Administration

The R. E. A. - the Rural Electrification Administration was created by executive order to promote by loans and otherwise the generation and distribution of electric energy in rural areas. Its capital is \$100,000,000.

The R. E. A. can affect the holding company indirectly thru the subsidiary in that the aid of this organization is available only in regions where the public utility rates are within limits set by the Authority.(1)

In fact, it can lend government money to build competitive generating stations if the power company's rate is not satisfactory.(2)

The R. E. A. has a "baby brother", the Electric Home and Farm Authority which takes up the electric financing where the R. E. A. leaves off.

### C. Regulation or Ownership

There are four ways by which government ownership of power facilities might come in the United States, thus eliminating

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(1) NATIONS BUSINESS, (July 1936), p.23

(2) IBID





the public utility holding company. First the success of the Tennessee Valley Authority; secondly, political manipulations, thirdly, public ownership through strict regulation; and lastly, public ownership through weak Federal legislation.

Public ownership may come if the Tennessee Valley Authority and similar enterprises should succeed on their merit and so sell the idea of public operation to the rest of the country. The Tennessee Valley Authority may succeed only politically by juggling costs, concealing subsidies, building up bureaucracies and buying votes with low rates at tax-payers expense.

Public ownership may come if federal regulation through the Securities Commission, Federal Power Commission and Federal Communication Commission and others should turn by subtle and perhaps unconscious stages into virtual and actual management of the utilities. Federal regulation, on the other hand, may be so weak and so homstrung as to prove ineffective and thereby persuade the nation that the only way to protect themselves against abuses is to own the utilities.

Frank D. Comerford believes:

"that the relations between the utilities and the regulatory bodies, both federal and state, will improve. The utilities are beginning to realize that many of the policies on which the federal government has embarked, notably the scrutinizing of security issues, the move toward simplification of corporate structures





and encouragement to economical integrating of power systems, are sound. The government will realize that the interests of consumers will be better served by co-ordination of existing facilities, whether privately or publicly owned, and not by wasteful duplication and a punitive campaign toward the private companies." (1)

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(1) PRESIDENT, EDISON ELECTRIC ILLUMINATING COMPANY OF BOSTON, AND CHAIRMAN, NEW ENGLAND POWER ASSOCIATION, in an article in the BOSTON HERALD (January 1, 1937) pg. 31 and 34





## SUMMARY

The public utility holding company is a holding company organized under state laws to control companies engaged in the public utility industry. The holding company, originally defined as a corporation organized to hold stock of another or other companies, is now defined as a company which by ownership of stock, controls other companies for management and financial reasons.

A study of the nature and history of the holding company and its significance in the utility field raises the question of whether or not some other type of corporate combination could have functioned as economically in this field. This question is naturally a matter of opinion and a weighing of the advantages and disadvantages from many viewpoints.

There are those who believe that the public utility holding company is a convenient means of financing, diversifying risks and conducting large-scale business under the various laws of 48 states and abroad. There are those who feel that this device is an instrument for manipulating and concentrating power and wealth on a large-scale to the detriment of the public, both investor and consumer.





Holding company control and management of public utility holding companies has resulted in developments to the advantage of the operating company, the investor, and the consumer. Holding company control has also resulted in developments detrimental to the interests of the operating company, the consumer, the investor, and the social policy. The abuses and the vices that have been created or fostered by this corporate device have cast serious reflection on the history and the objectives of the holding company.

It must be kept in mind that while in our economic organization we rely mainly on private initiative to carry on the operations of industry and commerce, we can resort to government intervention in the form of prohibition or regulation of any industry or organization of industry which fails to function properly. Fundamentally, the right of a corporation to own stock representing shares of ownership in another corporation is a privilege granted by the sovereign power which can revoke the privilege at its will.

Should the states revoke this privilege? Most people will agree that despite the evils and abuses that have crept in, the holding company in the utility field is fundamentally sound. If this form of business organization is sanctioned economically, steps must be taken to eliminate the shortcomings. This takes the form of regulation.





By what means and how far should the public utility holding company be regulated? I have pointed out that the utility holding company is now subject to regulation because it bears a relationship with the corporation problem, the trust movement and the utility problem.

The holding company in the public utility field is subject to regulation in the respect that all corporations are subject to both state and federal laws which govern their activities. This class of holding companies are subject to the same restrictions that apply to all corporations, and have the same problems which rise from the granting of the privilege of limited liability and transferability of ownership. In addition, as was pointed out, they have the privilege of stock ownership and control.

Any change in the law for all corporations would affect the holding company on the same basis that any corporation would be subject to changed regulations. The tightening of corporate regulation would naturally not cover all of the abuses and evils found in the utility holding company, but it is felt that if the separate state corporation practices and laws were revised, it would be a step in the right direction. However, with the diverse laws of forty-eight states, there is hope of small progress for the regulation of the holding company in the





public utility field through the corporation.

Nevertheless, as in the past, the companies were encouraged through the possibility of consolidated tax returns to consolidate into holding companies; so now, a revision of the tax laws with regard to consolidation has discouraged the existence of the holding company. Federal regulation of corporate practice has gone a long way to limit the practices of the holding company as can be seen by the indirect and limited form of federal regulation of interstate commerce in corporate securities by the Securities Act of 1933 and the Securities and Exchange Commission Act of 1934.

In other words, we may expect slow progress through the state laws and greater progress through the efforts of the Federal Government notwithstanding all that has been said against interference with business.

The public utility company is subject to regulation as a part of the "trust problem"--using the term to mean the problem of "big business." Much legislation is directed against large organizations and any well-defined movement against the larger businesses would affect the holding company. However, big business is on the alert and will object strenuously against being singled out as the object of special legislation.





The holding company in this field may be regulated as a part of the trust problem--the term now used in the sense of the aggregation of capital towards monopoly and illegal economic ends. However, in the past, the tendency is not to consider it as a part of this movement because this class of holding companies is not subject to competition to a great extent and bears directly on an industry where monopoly is encouraged. However, it has a bearing on a competitive field--the financing business--and in the past, we have seen instances where there has been competition to gain control of units in a holding company system.

The public utility holding company also differs from the holding company in the industrial field since the latter cannot add to its earning power by corporate devices and because there is lack of opportunity for vertical integration in the former group.

These three differences show the necessity for treating the utility holding company separate from the industrials. Even within the holding companies affecting those industries which are termed, "public utilities," we find a differentiation. Strictly speaking, railroads and communication companies are public utilities; still, because they are subject to regulation by both state and federal authorities to a greater extent, and because they concern industry of national scope rather than that of local character, we exempt their holding companies from inclusion in the term, "public utility holding company."





The public utility holding company, in the past, has been regulated as a part of the utility problem. As has been pointed out, there are two views with regard to the utility holding company being a public utility. One view is that the holding company in this field is not a public utility legally and economically and is therefore not a part of the utility problem; while the second view is that the holding company bears so great a relationship that effective regulation of the "utilities" necessitates control of the holding company.

However, the "amphibiousness" of the public utility holding company, the diverse state laws, the conflict between federal and state rights, and the issue of public ownership have tended to defeat effective regulation.

Therefore, many people feel that in order to save the economically sound public utility holding company, it is necessary to have special legislation to control this form of business organization in the public interest.

They feel that the evils and abuses must be guarded against in the future because of the magnitude of the utility industry, the degree of concentration of control, the investor, and the consumer.

It is the belief of many that the public utility holding company can be regulated properly neither by the individual states nor by groups of states. Federal incor-





poration of public utility holding companies has not received public sanction. The demand for regulation other than by the individual or groups of states has resulted in a federal law providing for the gradual elimination of the powerful and unwieldy set-ups of holding company groups, now too powerful to be properly regulated.

Not only is this legislation aimed at this specific type of holding company, but we do also find that this type of holding company is affected by other legislation which is designed to simplify the corporate structure of all holding company groups by consolidation of various units because of the abolishment of consolidated income tax returns, and because of tax provisions on intercorporate dividends.

This simplification is also encouraged by exemption from the capital gains tax in shifting from one property to another in reorganizations.

The possibility of refinancing old debts at lower interest charges, and amendments to state corporation laws have also been factors in the elimination of units in the holding company structure.

Not only do we have this political interference with the holding company in the utility field, but we also have economic interference because of the relationship with the power issue. Since the holding company is affected by the operations





of its individual units, the competition of the city and federal governments with the local companies, in the matter of power, has affected it greatly.

The efforts of the national government has resulted in a tangle of litigation involving the use of Federal funds to finance municipal power plants, the Tennessee Valley Authority, and the Holding Company Act, calling for wholesale geographical simplification and integration of properties. The outcome of this bitter struggle is awaited, for should the government be successful, it would endeavor to bring the holding company in the industrial field under its control.

We can, therefore, come to the conclusion that the holding company in the utility field is a problem arising out of the privilege given to the corporation to own shares of ownership in another company. This problem is a part of and interrelated with the corporation problem, the trust movement, the power issue, and public ownership. Nevertheless, it is worthy of study and recognition as a problem separate from the others, not part of the utility problem, but part of the holding company movement, the successor to the trust movement.





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